

**MASTER
NEGATIVE
NO.94-82147- 13**

COPYRIGHT STATEMENT

The copyright law of the United States (Title 17, United States Code) governs the making of photocopies or other reproductions of copyrighted materials including foreign works under certain conditions. In addition, the United States extends protection to foreign works by means of various international conventions, bilateral agreements, and proclamations.

Under certain conditions specified in the law, libraries and archives are authorized to furnish a photocopy or other reproduction. One of these specified conditions is that the photocopy or reproduction is not to be "used for any purpose other than private study, scholarship, or research." If a user makes a request for, or later uses, a photocopy or reproduction for purposes in excess of "fair use," that user may be liable for copyright infringement.

The Columbia University Libraries reserve the right to refuse to accept a copying order if, in its judgement, fulfillment of the order would involve violation of the copyright law.

Author:

American association of
advertising agencies

Title:

Analysis and criticism of a
study entitled...

Place:

[New York]

Date:

[1935]

94-82147-13

MASTER NEGATIVE #

COLUMBIA UNIVERSITY LIBRARIES
PRESERVATION DIVISION

BIBLIOGRAPHIC MICROFORM TARGET

ORIGINAL MATERIAL AS FILMED - EXISTING BIBLIOGRAPHIC RECORD

253.6

H112

American association of advertising agencies.

Analysis and criticism of a study entitled
Advertising agency compensation; theory, law,
practice, published by the Association of na-
tional advertisers in November, 1934. Made for
its members by American association of adver-
tising agencies. , New York, American association
of advertising agencies, c1935,
101 p. 28¹/₂cm.

Lithographed.

RESTRICTIONS ON USE:

TECHNICAL MICROFORM DATA

FILM SIZE: 35mm

REDUCTION RATIO: 16x

IMAGE PLACEMENT: IA IIA IB IIB

DATE FILMED: 6/28/94

INITIALS: DG

TRACKING #: MSH 01671

FILMED BY PRESERVATION RESOURCES, BETHLEHEM, PA.



2.5 mm
ABCEFGHIJKLMNOPQRSTUWVXYZ
abcde fghijklmnopqrstu vwxyz
1234567890

2.0 mm
ABCEFGHIJKLMNOPQRSTUWVXYZ
abcde fghijklmnopqrstu vwxyz1234567890

1.5 mm
ABCEFGHIJKLMNOPQRSTUWVXYZ
abcde fghijklmnopqrstu vwxyz1234567890



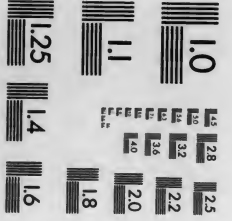
PM-MGP 13"x18"
METRIC GENERAL PURPOSE TARGET
PHOTOGRAPHIC



200 mm

150 mm

100 mm



ABCEFGHIJKLMNOPQRSTUWVXYZ
abcde fghijklmnopqrstu vwxyz
1234567890

ABCEFGHIJKLMNOPQRSTUWVXYZ
abcde fghijklmnopqrstu vwxyz1234567890

ABCEFGHIJKLMNOPQRSTUWVXYZ
abcde fghijklmnopqrstu vwxyz
1234567890

ABCEFGHIJKLMNOPQRSTUWVXYZ
abcde fghijklmnopqrstu vwxyz
1234567890

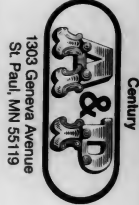
1.0 mm
1.5 mm
2.0 mm
2.5 mm



A4

A5

A3



PRECISIONSM RESOLUTION TARGETS

ABCEFGHIJKLMNOPQRSTUWVXYZ
abcde fghijklmnopqrstu vwxyz
1234567890

4.5 mm
ABCEFGHIJKLMNOPQRSTUWVXYZ
abcde fghijklmnopqrstu vwxyz1234567890

3.0 mm
ABCEFGHIJKLMNOPQRSTUWVXYZ
abcde fghijklmnopqrstu vwxyz1234567890



ANALYSIS *and* CRITICISM

of a study entitled

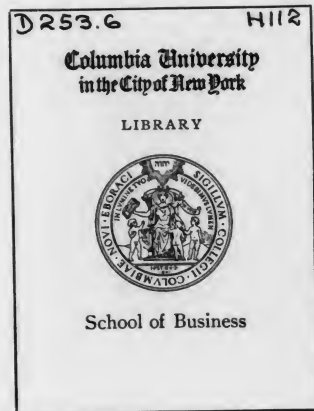
Advertising Agency Compensation

Theory - Law - Practice

Initiated by the American Association of Advertising Agencies

Made for its members by

AMERICAN ASSOCIATION of ADVERTISING AGENCIES



ANALYSIS *and* CRITICISM

of a study entitled

Advertising Agency Compensation Theory · Law · Practice

Published by the Association of National Advertisers
in November, 1934



COLUMBIA
UNIVERSITY
LIBRARY

Made for its members by
AMERICAN ASSOCIATION *of* ADVERTISING AGENCIES

COPYRIGHT 1935 BY
AMERICAN ASSOCIATION OF
ADVERTISING AGENCIES

ALABAMA
BIB
35-56989
LIBRARY

D 253.6
H112

35-56989 April 26, 1935 DA 1122

To A.A.A.A. Members:

After the Haase study of agency compensation was published last November by the Association of National Advertisers, an analysis of it was authorized by our Executive Board, to be made for the benefit of our members. The analysis has now been completed, in the following pages, and a copy is being sent to you for your information.

The Haase report is an elaborate study of 215 pages, which, while apparently seeking to weigh the merits and demerits of the agency structure, and if possible to work out a more satisfactory method of compensation, really devotes its endeavor to undermining the agency structure and basis of pay.

While the report might seem plausible to the casual reader, and does quote points of view both for and against the present method of agency compensation, it is so obviously biased in favor of a predetermined conclusion, that in no sense can it be regarded as being scientific. As our analysis will show, it contains too many misstatements and half-truths, vital omissions and mistaken inferences, to afford a reliable picture of the real situation.

It is to be regretted that an undertaking into which has evidently been put a great deal of time and effort, should not have been an impartial, scientific study, and thus have contributed to the solution of our mutual problems and commanded the confidence of all concerned.

In this respect it contrasts with the Young study made two

years ago, under the joint auspices of a group of large advertisers, leading publishers and the A.A.A.A., by an authority enjoying the confidence of all three parties and selected by the advertisers themselves. In that study Mr. Young, regardless of his conclusions, impartially revealed the elements of strength and weakness in the agency structure, as he found them.

Credit is due the A.N.A. for collecting and compiling a mass of information about agency operation, and methods of charging for agency service. This is helpful and interesting to all concerned, although it is regrettable that so many of the facts are presented incompletely or in ways which limit their usefulness.

The study offers no well worked out alternative to the present method of agency compensation, with substantial grounds for its adoption, merely presenting, as the analysis will show, a fallacious point of view that agencies are legally and morally free to rebate commissions, and proposing a contract which calls upon the agency to disregard its long established equities and obligations.

In making this analysis, we see no useful purpose in merely criticizing the Haase study in all its detail. We aim rather to clarify and refute the three main contentions, which vitally affect our business, and then to add, by way of constructive contribution, a statement of the true theory and real justification of the present method of agency compensation, as we have observed and experienced it over a long period of years.

That method of compensation is a time-tested institution, and has the signal virtue of having worked in advertising as none other

has ever done. But there is nothing static or sacrosanct about it. Like any other commercial practice, it is always subject to such revision as changing conditions may require.

Besides all the partisan views which have their own selfish ends to serve, there is now, and has been for years, a sincere difference of opinion on the subject among fair-minded men, a difference which can be resolved only by mutualizing viewpoints of each other's needs and taking common ground.

The agency structure has admitted values and it has admitted faults, as is true of any business relationship. The advertising and publishing industry has admitted needs which are fundamental to its welfare. Advertisers are our joint customers, whose best interests are entitled to full consideration.

All of these things are steadily being weighed in the only scale which sensible minds accept -- that of practical usefulness. No good can come from any one-sided or partisan attack or from attempting to break down a deeply rooted method of doing business, unless or until something better can be found to take its place.

JOHN BENSON

PRESIDENT

New York, February 15, 1935

TABLE OF CONTENTS

	<u>Page</u>
GENERAL COMMENTARY ON HAASE STUDY	Introduction
SIX FORMAL CONCLUSIONS LISTED IN HAASE STUDY	13
1. Agency Is Agent of Advertiser Only	13
2. Advertiser Actually Pays Agency Commission	13
3. Agencies Themselves Fix Rate of Commission	13
4. Commission System Too Rigid	13
5. Commission System Changing in Actual Practice	13
6. Agencies Free to Rebate	13
THREE MAIN CONTENTIONS ANALYZED	14
I - HAASE CLAIM OF WIDESPREAD DISSATISFACTION WITH PRESENT METHOD OF AGENCY COMPENSATION	15
1. Quoted Statements of Three Advertisers	15
2. Quoted Statement of N. W. Ayer & Son	17
3. Analysis of Percival White Questionnaire	18
a) to 346 Advertisers	18
b) to 79 Publishers	20
4. Analysis of Haase Questionnaire to 8900 National Advertisers	21
a) 37.9% of Reporting Advertisers Unfavorable to Agency Commission	22
b) 10+% Returns from Haase Questionnaire Deemed Inadequate	23
c) Advertisers More or Less Unfamiliar with Agency Structure	25

II - HAASE CLAIM THAT COMMISSION STRUCTURE BREAKING DOWN AS EVIDENCED BY --	Page 27
1. Extent to which Advertisers Use Outside "Specialists" and Do Not Use Agencies' Specialized Services.	28
2. Extent to which "Direct" Advertisers Use Commissionable Media.	32
3. Advertisers' Part in Media Selection.	33
4. Advertisers' Control Over Agency Commit- ments for Space, Art and Mechanical Work, and Over Copy	35
5. Alleged Trend Towards "Direct" Placing.	36
6. Haase Data About Agency Charges; How Many Advertisers Billed at Card Rates; at Fixed Percentage on Net or Gross; on a Fee Basis.	39
III - HAASE CLAIM THAT AGENCY IS LEGALLY AGENT OF THE ADVERTISER; LEGALLY AND MORALLY FREE TO REBATE; COMMISSION SYSTEM FAULTY	42
1. Haase Arguments Against Commission System --	
a) Theoretical Objections	42
b) "Practical" Objections	43
Agency Commission Despite Its Defects, Constructive	45
2. Haase Claim That Advertising Agency Is Ex- clusively Agent of the Advertiser	46
3. Statement of Agency Status.	47
a) by Periodical Publishers Association	48
b) By American Newspaper Publishers Association.	49
c) by Court Decision in Clegg vs. New York Newspaper Union.	49

Agency May Properly Serve Two Masters of Adverse Interest	Page 51
4. Legal Status of Advertising Agency Summarized by Counsel for A.A.A.A.	52
His Analysis of Court Cases Cited.	53
5. Bearing of Legal Status on Agency Compensation.	60
Adverse Interest Between Agency and Client Defined.	60
6. Publisher's Vital Need of Agency Service and Right to Support It	62
Agency Structure Compared with Automobile Dealer Organization.	63
7. Why Agency Has No Right to Rebate Commission.	67
a) Effect of "Adverse Interest" Between Agency and Client.	67
b) Haase Conclusion Contrary to Public Policy of Federal and State Laws in Opinion of George Link, Jr., A.A.A.A. Attorney	67
c) Rebating a Breach of Faith; Violates Agency's Understanding with Publishers	69
8. Does Agency Commission Induce Either Over- spending or Biased Spending?	71
a) Three Practical Safeguards Against It.	71
b) How Advertiser Can Remove Temptation	72
9. Would a Fee System Remove Bias?	72
a) Three Hypothetical Situations Cited to Disprove	74
b) Honest and Competent Advice Obtainable Only from Honest and Competent Agencies.	75
c) Agency Record One of Loyalty to Client's Best Interest.	76

	<u>Page</u>
10. Are Agencies Overpaid?	76
a) Evidence Advanced by Haase Analyzed	77
b) Actual Profit Figures from A.A.A.A. Analysis of Agency Costs -- 1929-1933	77
c) Haase (Sheldon) Hypothetical Agency Costs Compared with Actual Figures from A.A.A.A. Analysis	79
d) Incomes of Agency Principals (Young Study).	80
e) Incomes of Account Executives (Young Study)	82
f) Financial Risks of Agency Business.	83
g) Cost of Agency Service to Advertiser.	84
11. Do Advertisers Pay the Agency Commission?.	85
12. Do Agencies Fix Rate of Commission?.	86
a) How Agencies Negotiate with Publishers.	86
b) 15% Unchanged Since 1918.	86
13. Do Agencies Earn a Commission from Media?.	87
a) For Credit and Collection Service	87
b) In Developing New Advertisers	88
c) Only 5.2% of Reporting Advertisers In- duced by Agencies to Start Advertising (Haase Figure).	88
d) Resultful Advertising, Not Solicitation, Main Factor in Developing New Business.	88
e) Solicitation of Large Advertisers on Increase (Haase Figures).	89
14. Does Agency Recognition Protect Advertisers?	89
a) How It Builds Up a Selective Group of Agencies.	90
b) Recognition Too Loose	90

	<u>Page</u>
15. Is Agency Compensation Too Rigid?.	91
a) Large Account Helps Finance Service to Small One	91
b) Flexible Rate Would Lead to Dicker.	92
c) Advertising Ideas Have No Known Market Value	93
d) Fee System Would Limit Agency Service	94
e) General Development and Scientific Work of Agency Needs Financing	94
f) Creative Effort Needs the Incentive of a Level Commission.	97
SUMMARY OF A.A.A.A. ANALYSIS AND ITS CONCLUSIONS	98

CONCLUSIONS OF HAASE STUDY STATED AND ANALYZED

There are six formal conclusions of the Haase study, listed in the summary of it, as follows: (Pages 3 and 4)

1. The advertising agency is the agent of the advertiser only.
2. It is the advertiser and not the publisher who actually pays the agency commission.
3. Agencies themselves and not publishers, fix the rate of agency compensation.
4. Major fault of the "discount" system is its seeming rigidity; does not permit of agency compensation being adjusted to needs of individual agency or advertiser.
5. "Discount" system has been modified in actual business practice.
6. Advertiser is free to make any terms he wishes with advertising agency. (And agencies may rebate commissions if they like.)

These six conclusions, while involved in, do not clearly represent or identify the three main issues raised in the study, as will be apparent in following through in our analysis.

No. 1 ties up with No. 6, which is the most significant conclusion -- namely, that agencies have a right to rebate commissions.

Nos. 2 and 3 are minor, and without vital bearing, merely contributing towards No. 6.

No. 4 gives a ground for advertiser dissatisfaction with the agency commission.

No. 5 claims that the existing structure has been "modified," i.e., is breaking down in actual practice.

Thus, some of these six conclusions are major and some are minor, and they all boil down in the study to three main issues, as follows:

- I. That there is widespread dissatisfaction with the agency commission system, among advertisers and among publishers, claimed to be evidenced by facts and opinions recorded in the study.
- II. That the commission system is breaking down, claimed to be evidenced mainly by the varying methods used by agencies in charging for their service; by a lessening use of agency service and dependence on outside talent by the advertiser; and, by a trend during recent years away from agency placing and towards "direct."
- III. That since the agency is the legal "agent" of the advertiser, and since therefore there can be no adverse interest between them, no transaction between them can be construed as rebating. Hence there is no objection, either legal or moral, to the agency's passing on to the advertiser whatever part of the agency commission it sees fit. (Claimed to be evidenced by legal argument and analysis of some 800 court cases.)

It will be shown herein that the first two conclusions are either contradicted by Haase's own data or inadequately supported by it, and that the third one listed is entirely fallacious, on both moral and legal grounds.

* * * * *

I. A MAJOR PREMISE AND A MAJOR CONCLUSION OF THE HAASE REPORT IS THAT THERE IS WIDESPREAD DISSATISFACTION WITH THE PRESENT SYSTEM.

A basic dissatisfaction with the present relationship between advertiser and agency is the very starting-point for the Haase study. Not only was the prevalence of such dissatisfaction assumed, even before the study was undertaken; it was frankly given by the Trustees under whose sponsorship the study was made as an underlying reason for making the study.

Thus, in the letter (to the Board of Directors of the Association of National Advertisers) transmitting the report, the Trustees say: (Page 1)

"The events of 1933 furnished the answer (i.e., as to the need for a study of advertising agency compensation). Against a general background of advertiser-dissatisfaction with the present system of compensation, two happenings occurred . . ."

So vital does the existence of this dissatisfaction seem to Haase that a very substantial part of the report is taken up with a painstaking attempt to prove it. And it is right here, in our opinion, that Haase's case first falls apart.

Part of the "evidence" of dissatisfaction relied upon in the Haase report are the following:

1. Quoted Statements from Three Advertisers:

(Pages 21 and 22)

One of them is quoted as having the following specific fault to find: 15% is too much for the large advertiser to pay, and too

little for the smaller one; and in the case of the former he also felt that a high gross income induced agencies to provide services which were either not needed or duplicated what the advertiser was equipped to do himself.

This is by far the most influential opinion quoted in criticism of the agency commission. It comes from a very large advertiser, who values agency service and uses it extensively in all branches of promotion, through a number of the best known "full-rate" agencies in the country.

The second was quoted as saying ".... The advertising agency should represent the advertiser and be compensated by the advertiser. It is my belief that the advertiser can then demand and obtain real service." Obviously, what this complainant was eager for was not a different method of compensation, but for better service, and how that could be obtained by a different method of compensation is not made clear.

The third was from a smaller advertiser who said he wanted "an agency which is equally interested in every type of advertising and sales promotion work"; also (what everyone knows to be true) that he should never expect to get the kind of service he demanded if he "paid nothing but the standard rates allowed by the publications." Of course there is nothing in the existing system of compensation that prevents advertisers from effecting mutually satisfactory and profitable arrangements with their agencies for such special services as this advertiser was referring to.

From the standpoint of quoted complaints by advertisers, and

without in the least minimizing the authorities who made them, the three foregoing instances constitute the record on which Haase relies for a major conclusion in his document; and of those three, one was written in 1921 -- thirteen years ago; one in 1927, seven years ago; and only one as recently as 1932.

As a further and important witness against the agency commission, Haase refers to the late F. Wayland Ayer of N.W. Ayer & Son, as an advertising agency authority opposed to it. (Pages 23 and 143)

"The strongest evidence of dissatisfaction on the part of an advertising agency with the discount system is the policy of N.W. Ayer & Son -- for many years one of the leading agencies. Finding the system unsound as applied to agents who sought to be agents of the advertiser, N.W. Ayer & Son, over forty years ago, abandoned it entirely, setting up its own basis of payment on a principle at variance with the discount theory."

This testimony is not so significant as might seem at first blush. In the first place, the change was made "over forty years ago," at a time when advertising publication rates and discounts were in a state of chaos, and N.W. Ayer's pioneer move of crediting the latter all to the advertiser and imposing a uniform rate of commission became the forerunner of a standard agency compensation.

As a matter of fact, imposing a fixed percentage of 16-2/3% on the total net, regardless of volume, is as rigid a billing system as any known in the agency business. And is rigidity not the main objection raised by advertisers to the agency commission?

In Mr. Ayer's letter to Editor & Publisher, of March 21, 1921, quoted in full in the Haase study, (Page 143) Mr. Ayer makes the following statement:

"That the agent renders a service to publishers in the development of new advertising and in the assumption of credit risks, is a recognized fact, and that this service should be rewarded by a differential which gives the agency an advantage in the purchase of space is only fair and just."

Evidently, Mr. Ayer was not opposed to an agency commission as a means of compensating agencies for service rendered the publisher, in which the publishers themselves have come to include as a major factor services rendered the advertiser in making the advertising productive.

Four adverse publisher statements are also quoted (Pages 22, 23 and 26) -- made way back in 1921; one by a well-known teacher of marketing at Harvard; and three adverse statements from agency men, two of whom are not very active in the business today, and one of whom favors the agency commission as compensation for advertising service, but not for general promotion or commercial service. There are also quoted favorable statements (Pages 20 and 21) from one leading agency head, one modern publisher and an official of the A.A.A.A. Why are not more opinions quoted of influential present-day media owners and agency heads?

2. Results of a Questionnaire Sent by Percival

White to 346 Large Advertisers in 1932. (Page 24)

Haase gives the results of a questionnaire sent by Percival White in 1932 to 346 advertisers asking their opinions as to satisfaction or dissatisfaction with the agency commission. 149 replies were received, or 43%, distributed as follows:

47	avored a fee system of compensation
35	avored the commission system
24	willing to go along on a commission basis
	until a better method can be found
43	non-committal
149	

Haase deduces from these figures that 71, or 67% of the 106 who registered an opinion, were opposed to the agency commission.

A more fallacious interpretation of those figures could hardly be conceived. In the first place, the 24 willing to go along with the commission system do not belong in the "opposed" column at all, even if they do have strong objections to it; they prefer it to any other alternative so far proposed. In the second place, the 43 non-committals are not to be overlooked. They are significant. Why were they non-committal, when they replied at all? If you divide them into favorable and unfavorable in the same ratio as the "for" and "against" figures bear to each other, that is 59 to 47, you get 24 to add to the favorable column, or a total of 83 in favor as against 66 opposed. That is a very different picture.

And what about the 197 who did not reply? Were they indifferent to the question, as being of no importance to them, or were they content with things as they are and out of sympathy with any agitation?

3. Answers to a Questionnaire Sent Out, in 1932, by Percival White to 49 Consumer Magazines, 7 Trade Magazines, and 23 Newspapers. (Page 24)

Of the 79 publications queried, 29 replied -- and of the 29, 10 favored the commission system, 5 had given strong views against the commission system but "were willing to submit to it until something better is found," 7 were in favor of the fee system, and 7 were non-committal.

From which Haase deduces that "a majority of those who had given thought to the question were opposed to the present system."

The figures, we submit, prove nothing of the sort. In the first place, there is no information as to how important were the publishers who replied -- or went on record as opposed to the commission system.

Of the 22 who did express an opinion a two-thirds majority, or 15, went on record definitely either as being in favor of the commission system or as preferring it to the fee system or any other that had yet been proposed.

The fact is that Haase found that out of 79 publishers, there were 7 (approximately 9%) who were sufficiently dissatisfied with the present system, first to cause them to reply to the questionnaire, and second, to express a preference for some specific substitute for the commission system. And who were the seven? The record does not disclose. (As a matter of fact, we have since

learned two of the seven were magazines, one a newspaper, three trade papers, and one a book publisher!)

Haase makes the point that it is the "high rate" publications which favor the agency commission, more than do the low rate publications. In other words, it is the dominant and widely influential consumer media which are most convinced of its constructive value to them and to advertising. Could there be a more experienced point of view?

4. Questionnaires Returned by 924 Advertisers. (Pages 34 to 52)

Haase sent questionnaires to 8900 national advertisers.

Among the questions asked, bearing on "dissatisfaction" of advertisers, were the following:

"What is your attitude toward the discount ('commission') system of agency compensation?"

"Do you believe there are legal or moral restrictions which require you to compensate your agency by a discount or 'commission' arrangement?"

"What method of agency compensation would you prefer if you believed you were able to make an unhampered choice?"

"If all advertising mediums were available at one and the same price to all advertisers and all agents, would you continue to use an advertising agency because of its specialized ability at a price mutually agreeable?"

"Please make any comments you care to on the subject of advertising agency compensation."

These questions are all pertinent and reflect sentiment of the advertiser, but only one, the first, asks the advertiser his attitude towards a system which he knows by experience -- whether favorable or unfavorable.

The other questions are theoretical, or are based on suppositions.

Hence, the answers to the first question would appear to be the most valid registration of advertiser opinion derived from the A.N.A. questionnaire. What do they show?

924 advertisers replied to the questionnaire. Of the 924, 821 answered the question as to their attitude (favorable or unfavorable) toward the commission system. Of the 821, 493 were favorable, 311 were unfavorable, and 6 were favorable "with restrictions," and 11 were doubtful. (Table XXVII)

Of the 821 who answered this particular question, 311, or 37.9%, stated that their opinion was unfavorable.

This figure, therefore -- namely 37.9% -- is the highest figure that can justifiably be used to measure the extent of the "general background of dissatisfaction." This is quite different from "approximately" 60% used by Haase in his summary of replies recorded in Table XXIX, in answer to the theoretical question: "What method of agency compensation would you prefer if you believed you were able to make an unhampered choice?"

Haase's statement is as follows: (Page 35)

"This dissatisfaction is evidenced by Table XXIX, which indicates that approximately 60% of those reporting preferred some sort of fee basis for compensation of advertising agencies."

Incidentally, deducing 60% from Table XXIX seems unreliable because the various preferred methods of compensation reported are so mixed as to any single classification, that no clean-cut analysis can be made, and also because no sorting of the answers, in our opinion, could possibly yield such a percentage of advertisers preferring the fee system.

What is far more important, why should Haase emphasize the answers to the hypothetical and unreliable question when he has a much more reliable and significant figure in the 37.9% of reporting advertisers unfavorable to the commission, derived from Table XXVII and representing the answers to his question: "What is your attitude toward the discount (commission) system of agency compensation?" In measuring the extent of "dissatisfaction" we submit that the answers to the question: "Are you favorable or unfavorable?" are far more significant than the replies to the question: "What would you prefer if you had an unhampered choice?"

* * * * *

It is also important to bear in mind, in interpreting these figures, that questionnaires were sent to 8900 advertisers -- among whom there was supposed to exist a strong and general feeling of dissatisfaction. And yet, of that 8900, only about 10% took the trouble to answer. In view of all the circumstances this seems like a surprisingly small response. It should be borne in mind that here was no ordinary questionnaire, sent out without

adequate credentials. It was, on the contrary, a study being made in the interest of all advertisers; being made by a highly respectable and nationally-known organization, the Association of National Advertisers; and being made for the purpose of correcting unsatisfactory conditions, if unsatisfactory conditions should be found, in connection with client-agency relationships. Also, the letter accompanying the questionnaire, while impartial in tone, made a challenging appeal in stating that the study was part of a large undertaking to help advertisers and the whole industry and to define legal rights.

Does a 10% reply, in such circumstances, suggest that there is a "general background of dissatisfaction"? Would not the silence of the other 90% indicate that there was in the minds of the vast majority of advertisers no urgent feeling at least that the present system needed "reforming."

A more realistic interpretation of the information contained in the answers to the questionnaire is this: that of 8900 advertisers to whom questionnaires were sent, 10% were sufficiently interested in the subject-matter of the inquiry to reply; and 311 advertisers, or 3.5%, of all the advertisers queried, expressed themselves as being unfavorable to the commission system of compensation. A rather slender base on which to build such words as "general background of advertiser dissatisfaction," a "basic dissatisfaction with agency relationships," "a tendency toward breaking up of the discount system," and the like -- even though the silent 90% included many who had little at stake and no interest

in the matter, and some whose replies would have been negative had they been made.

Undoubtedly, also, many of the reporting advertisers were A.N.A. members, whose views of the agency commission have been steeped in a hostile attitude towards it for years and could not be wholly unbiased.

Moderate as the showing is of an adverse attitude towards the agency commission, we believe it would have been far less if those replying to the question had been fully informed about the broadly constructive aspects of the agency commission in building up agency service and advertising volume, upon which low rates depend.

The bulk of those answering this question were small advertisers, least likely to have such a knowledge and wholly concerned, as most people are, with their own immediate affairs. (442, or 53.8%, spending less than \$50,000 per year - Table XXVII.)

Haase says in the beginning of his report: "No understanding of the present advertising agency compensation system is possible without a knowledge of the system's background." He might have gone a step further and added that no understanding is possible without a full knowledge of the structure and purpose of the agency commission, as well as its effect upon the welfare of all three factors -- advertisers, agencies and media owners.

The average advertiser may operate under the agency commission as a matter of long established custom, and still not understand the theory of it; he merely sees an element of cost imposed upon him by the media owner. Unless he can see all sides of the

system, how it works, what it accomplishes for advertising as a whole and for agency service, he would be very likely to be negative about the set-up however well satisfied he was with his own agency relationship.

If you were to ask the average insured whether he would like to see the life insurance commission abolished, he would say "yes," of course. Why shouldn't he, until he learns something about the insurance structure, how important a service the soliciting forces render him in keeping down mortality cost by adding young and healthy risks? If it were not for the active work of these creative men, either insurance volume would go to pot or there would be adverse selection of risks. The old and the sick would voluntarily apply.

The agency commission renders much the same kind of service by stimulating agency effort to maintain volume and thus stabilize rates.

* * * * *

II. THE SECOND MAJOR CONCLUSION OF THE HAASE STUDY IS THAT THE AGENCY COMMISSION STRUCTURE IS BREAKING DOWN

as evidenced by:

1. The extent to which advertisers go outside of their agencies for special service and fail to use the special services of their agencies.
2. The extent to which direct advertisers use commissionable media, often at net rates.
3. The extent to which advertisers select media themselves, without the assistance of their agencies.
4. The extent to which advertisers insist on approving commitments for their account made by the agency, for space, art and mechanical work and also copy.
5. The trend towards placing "direct" by advertisers rather than through the advertising agency.
6. The varying ways in which agencies charge for their services, aside from the commission system or at variance with it.

These "evidences" were derived from answers to such questions in the A.N.A. questionnaire as the following: (Pages 171, 172 and 173)

Who chose the media in which your advertising appeared?

Do you require your agency to receive your approval before making any commitments for space, art work in your name?

Do you require the agency to submit all advertising copy for your approval?

What method was used in 1933 for compensating your agency?

Did you place any advertising direct in any discount media?

Approximately what percentage was placed through the agency and what percentage direct?

In analyzing each of the six evidences above mentioned, they will be shown either to be of little or no significance in proving any breakdown of the structure, or to be unsupported by the facts contained in and compiled by the study itself.

1. The Use by Advertisers of "Specialists"
and the Non-Use by Advertisers of the Special
Services Rendered by Their Agency.

First, Haase "proves" the inadequacy of agency service, by showing (Table III) that 430 out of the 924 advertisers answering the questionnaire employ outside specialists to do "what the agency is presumably equipped to do." It will be noted (Table XIV) that 298 of the 430 employ free lance artists, 168 employ creators of window and counter displays, and 128 employ direct mail specialists. Other "specialists called in to do what the advertising agency is presumably equipped to do" include management engineers, display installation services, exhibition specialists, motion picture producers, electrical transcription producers and premium goods specialists!

Agencies, as a rule, are not supposed to render such a variety of special services. Many could not do so as economically as specialists who do nothing else, nor perhaps as efficiently. And advertisers are better off having a free range of choice, if their

own agency does not happen to be as well equipped for a certain job as some other.

And yet the importance attributed by Haase to this showing is indicated by the following quotation from the report (page 37):

"The table shows the number of advertisers, by size of appropriation, who employ such outside specialists It is interesting to note that nearly 52% of all reporting advertisers use such specialists. Based upon this evidence alone, it is no wonder that 40% of those reporting voice more or less dissatisfaction with the discount method Obviously, this emphasizes the necessity for analysis and diagnosis. The conclusion appears inescapable that: Where there is so much dissatisfaction, there must be some defect in the system of advertising agency compensation."

This is "specious" reasoning -- since not even the premise, to say nothing of the conclusion, is sound.

Similarly, Haase finds conclusive evidence of dissatisfaction in the fact that many advertisers do not avail themselves of all the "special services" rendered by the agency; and this non-use of special services he attributes to the fact that the basis of compensation is wrong.

Thus 60.9% of the advertisers answering the question indicate that they use the special services of the agency; 39.1% do not avail themselves of those services. (Table III) There must be some reason why those services are not used, reasons Haase; and the only reason that he can think of is, "because the terms on which it is offered are not satisfactory to the business men who would otherwise use it."

How does Haase know that the business men "would otherwise use it"? How does he know but that perhaps there are some clients who have no need whatever for some of the services rendered by their agency? Did it not occur to Haase to notice that the advertisers who make the greatest use of the agency's special services are likewise the ones who make the greatest use of outside specialists? Did he not notice the seeming coincidence that in both cases it is the larger advertisers who are found most frequently to avail themselves of the special services -- both those rendered by the agency, and those obtained from outside?

The figures (found at page 36 of the report) are illuminating on this point:

111 out of 124 advertisers (approximately 90%) in the class above \$250,000, utilize the special services of their own agencies; and 83 of the 124 engage the services of outside specialists.

All but one of the 31 advertisers in the million-dollar category use their agencies' special services; and all but two of the 26 advertisers in the \$500,000 - \$1,000,000 do likewise. And these same two groups are the ones which avail themselves most of the services of outside specialists.

At the other extreme, we find that the advertisers under \$50,000 make the least use of special services, whether furnished by the agency or not. 47.6% of this group utilize their agencies' special services; and 43.8% engage outside specialists.

It seems apparent that the extent to which advertisers use special services depends very largely on their need for them; that in the very nature of things the larger advertiser is likely to

realize a greater need for special services than the smaller advertiser; that the greater extent to which the larger advertisers invoke the aid of outside specialists, at the same time availing themselves of the special services of their own agencies, indicates no dissatisfaction with the failure of the agency to render still other services; and that the relative infrequency with which the smaller advertisers use the special services of their own agencies, being matched with a similarly less general use of outside specialists, indicates merely a lesser need for such special services, or inability to pay for them, and is in no sense an indication of dissatisfaction with the agency's basis of compensation. It would be absurd to expect that all advertisers would use all facilities an agency has to offer or find all facilities needed by them in every organization.

Undoubtedly many agencies do not have as broad facilities as their clients could utilize, but that is not due to the agency commission. It is mostly due to lack of advertising volume to finance the extra cost. In fact, if it were not for the uniform rate of pay assured by the agency commission, the modern agency could never have developed the highly organized facilities of today; it could not have financed them.

On the other hand, there is such a variety of service available and of talent employed in the well established agency, that some leaders are beginning to feel we have gone too far afield in directions not strictly related to advertising. It is not much over two years ago that a president of the A.N.A. publicly

criticized agencies for spreading out too much and not confining themselves to copy, media, etc., as their proper function.

2. The Extent to Which Advertisers Using Commissionable Media Still Place Their Advertising Direct Instead of Through an Agency.

On Page 37, the report says:

"A more striking evidence of dissatisfaction with the system is the fact that, of the 94 direct advertisers reporting, 57, or 61% of them, use discount mediums -- in many cases buying at net rates." (Table XVII)

Not very striking evidence, when you examine it.

In the first place, 40 of the 57 advertisers in this group have total appropriations under \$50,000, some doubtless much under \$50,000. Thus it seems likely that as to many of these advertisers, the space commissions alone might be negligible and even an adequate fee out of the question; that the account was too small to stand the expense of a fee and that therefore no agency was engaged. And furthermore, many of such advertisers might have placed the bulk of their advertising in non-commissionable media, including newspapers on a local rate basis.

Haase, in interpreting these figures, has started wrong end to. The measure of dissatisfaction, if any, would be determined not by the percentage of direct advertisers using commissionable media, but by the percentage of users of commissionable media who placed their advertising direct rather than through an agency.

As nearly as we can ascertain from the report, 852 of the answering advertisers use "discount media." Of these 852, 57 -- or slightly less than 7% -- appear to place their advertising direct. And of the 57, as was pointed out above, 40 spend a total of less than \$50,000 per year for all advertising expenditures; how much less is not indicated, nor how much is spent on non-commissionable items.

Of the 231 advertisers (with appropriations of \$100,000 or more) using commissionable media, only 7 -- or 3% -- place their advertising "direct."

Those figures make no contribution to the theory that the agency system is breaking down, or that there is general dissatisfaction with the system of compensation.

3. The Extent to Which the Advertiser Exercises a Voice in the Selection of Media.

(Table XI)

Here we find another unwarranted interpretation of the questionnaire, and a still more unwarranted and illogical deduction from that interpretation.

At page 43, the report says:

X "There are few services the agency can perform for the advertiser more important than that of selecting mediums, and, presumably, few for which the advertiser needs the services of the agency more. Nevertheless Table XI shows that, of 825 advertisers answering this

question, only 34 permit their agencies full scope in the selection of mediums, and 201, or nearly 25%, allow their agencies no voice whatever The testimony indicates that the advertiser does not utilize his agency to the extent that the agency's facilities should justify." (The underscoring is ours.)

The wording of the question itself is very important, in considering this claim. It reads as follows: (Page 171)

"Who chose the mediums in which your advertising appeared?

"Mediums selected by agency

"Mediums selected by advertiser

"Jointly by advertiser and agent"

201 answered "selected by advertiser." And this answer is distorted into meaning that these 201 advertisers "allow their agencies no voice whatever."

It is entirely conceivable that out of the 201 there were some advertisers who actually did give their agencies no voice whatever, either in making the decision or in arriving at it. But it is likewise not only conceivable, but entirely probable, that a majority of the 201 who said they selected media themselves received recommendations from the agency and gave to those recommendations some degree of weight. The point is that no one can say, from the answers to the questionnaires, that 201 -- or any other number -- "allow their agencies no voice whatever."

But even Haase's own interpretation of the answers falls far short of establishing any breakdown of agency service, or any

dissatisfaction with agency compensation. Even if 25% of all advertisers really did make their own media selections -- without any help or advice whatever from their agencies -- there might be other good reasons for doing so. Many advertising managers through long experience know media, especially those adapted to their own line of business, and feel able unassisted to select media themselves. In doing so they are not necessarily implying a lack of confidence in the ability or disinterestedness of the agency. Some of them also may foolishly be dealing with a poor agency, perhaps a rate cutter, which does not know media as it should. That is no reflection on the large body of competent agencies which do. The fact that at least 75% of all reporting advertisers either depend upon agency selection of media or cooperate with the agency in making it, speaks for itself.

4. The Extent to Which the Advertiser Insists on Approving Commitments for Space and Art and Mechanical Work, and Also Copy. (Tables XIX and XX)

If this point is raised to indicate that the agency set-up is breaking down, it has no importance.

X It has always been customary for an advertiser to approve copy and expenditures incurred for his account. That is nothing but business sense.

5. The Tendency, Beginning About 1930, for More Advertisers to Discontinue the Use of an Agency, and for Fewer Direct Advertisers to Take on Agencies. (Pages 53, 54, 55 and 56)

Haase sees in the figures showing the switches from direct-advertisers to agency-advertisers, and from agency-advertisers to direct-advertisers, a great deal of significance. He reads into these figures confirmation of his belief that the agency system is breaking down; that

X "It might be inferred that advertising agency service, as generally interpreted, is becoming less well adapted to the needs of present day business firms, since the trend toward direct advertising seems to have been established." (Page 56)

Let us see what these figures mean.

The figures cited in the report show the following switches from agency-advertisers to direct-advertisers, in the years 1925 through 1933: (Taken from Standard Advertising Register)

<u>1925</u>	<u>1926</u>	<u>1927</u>	<u>1928</u>	<u>1929</u>	<u>1930</u>	<u>1931</u>	<u>1932</u>	<u>1933</u>
428	461	400	274	425	514	534	594	628

During the same period, the switches from direct- to agency-advertisers were as follows:

<u>1925</u>	<u>1926</u>	<u>1927</u>	<u>1928</u>	<u>1929</u>	<u>1930</u>	<u>1931</u>	<u>1932</u>	<u>1933</u>
215	267	276	258	235	272	256	266	229

In 1933, there was a net switch away from agencies of 399,

whereas in 1926 the net switch was 194, and in 1929, 190, and in 1928 only 16. (Assuming that the figures given are correct)

But in any event a net loss (by the agencies) of 400 advertisers -- out of a total of 8,666 -- in a depression year is hardly convincing evidence of the breakdown of the system, especially in the light of the following facts:

In 1933, 830 of the 924 advertisers who answered the Haase questionnaire were still using agencies. (Table XVIII, page 178)

And of the 94 who placed their advertising direct, 69 had total annual appropriations of less than \$50,000, and 82 had appropriations of less than \$100,000, 3 being undesignated as to size. Only nine advertisers (of those spending \$100,000 or more per year) out of 247 (or about 3.6%) were getting along without an agency, and there is nothing in the report to indicate what channels these few advertisers were using -- how much trade press, direct mail or sales material.

Such figures certainly do not indicate that advertisers are abandoning the agency system and placing their advertising direct. The fact that 96.4% of all advertisers spending \$100,000 per year or more are placing their advertising through agencies is sufficient proof to the contrary.

But of course the phenomenon which Haase has discovered is the most natural thing in the world.

In a period of depression advertising appropriations shrink, and consumer media are often all but eliminated, so that many smaller advertisers drop below the minimum level at which agency

service is needed or is economically sound. Those advertisers become, for the duration of the depression or of their curtailed advertising expenditures, direct-advertisers -- not because of any dissatisfaction with agency service, but of very necessity.

And conversely, the number of direct-advertisers who graduate upward each year (during the depression) to a level where they require agency service diminishes. Hence the increase -- beginning in 1930 -- of the number switching from agency to direct, and the decrease, at about the same time, of the number graduating into the agency classification.

The Standard Advertising Register is a valuable compendium of information, but using it for calculations of this kind is not reliable, in our opinion. There are too many arbitrary changes made in the listings from year to year. For instance, in 1928 about 500 direct advertisers were eliminated simply because they were deemed to be "insignificant." That one change would throw 1928 all out of true and also the chart on page 55 of the Haase report. Instead of a net gain of 16 direct advertisers that year there would have been a gain of 516 if the records had not been changed -- considerably more than the 399 added in 1933.

This little shift in the figures presented in the Standard Advertising Register for 1928 throws a revealing light on one of Haase's charges of agency incompetence when he says in the report on page 54, "It is obvious from the chart on page 55 that the direct advertiser quit advertising in 1928, just before the impending depression"; and "the reason for this situation may well

lie in the fact that the direct advertiser is more responsive to changing business conditions than the agency-guided advertiser."

Haase based his statement on the erroneous assumption that the gain in direct advertisers in 1928 was 16, whereas it really was 516.

6. What the Haase Study Shows About Agency Charges and the Practice of Rebating.

It shows nothing intelligible about either the amount of the charges or the degree of rebating, or in fact, whether any exists.

Table XXI, sections a, b, c, d, and e, dealing with consumer media which are commissionable to agencies, namely, magazines, newspapers, radio, outdoor and farm papers, all at national rates, shows how many advertisers are billed at card rates, how many at a fixed percentage on net or gross billing, how many on a fee basis, the speculative basis being negligible. But none of these figures indicate what percentage is added to the net or gross nor how large the fee; so that it is impossible to tell to what extent there is any rebating.

Covering all five major consumer media, the fee basis averages less than 4% of reporting advertisers; the percentage basis less than 11%, and the card rate or better basis, over 85%. Even if we were to assume the highly improbable contingency that all the fees and likewise all the percentages charged on total net or gross amount to less than card rates, the table would show less than 15%

of all reporting advertisers by any possibility receiving a rebate, however slight. It might be much nearer 10%, if the facts were known. These two limits coincide with the ones estimated by the Young study a year or two ago.

According to Table XXI, sections a, b, c, d, and e, the individual percentages for each class of media were reported as follows:

In magazine advertising: 86.6% of reporting advertisers are billed at card rates or better; 8.7% at fixed percentage on net or gross; 4.4% on a fee basis.

In newspapers: 86.5% of reporting advertisers are billed at card rates or better; 10.0% at fixed percentage on net or gross; 3.5% on a fee basis.

In radio (national): 87.2% of reporting advertisers are billed at card rates or better; 8.9% at fixed percentage on net or gross; 3.1% on a fee basis.

In outdoor (national): 82.9% of reporting advertisers are billed at card rates or better; 13.2% at fixed percentage on net or gross; 3.9% on a fee basis.

In farm papers: 83.0% of reporting advertisers are billed at card rates or better; 13.2% at fixed percentage on net or gross; 3.8% on a fee basis.

There seems to be nothing new in these findings, except perhaps the evidence that accounts of \$1,000,000 and over follow most strictly the standard card rate basis of agency charges.

If the compilations were confined to strong and able agencies and to high-grade accounts, the amount of demoralization might be close to negligible. The study throws no light on that.

It does not look from these figures as if the agency commission

system is being modified; 10% to 15% demoralization in any line of business is not serious, however undesirable, human nature being what it is and competition as keen as it has become.

As a matter of fact and of agency experience in the field, there is vastly less rebating now than there was twenty years ago. Many of the rebating agencies have gone out of business and some of the rebate-seeking advertisers have changed to full rate service, as agency records will substantiate.

* * * * *

It is upon such evidence as the foregoing six points present (pages 12 to 24) that the Haase report seeks to demonstrate that there is among advertisers a serious breakdown of the present system. It is such evidence, the report says in summing up on this point, that "indicates a weakening of the position of the advertising agency, and an increasing tendency for the business house to deal directly with mediums."

Actually, the evidence proves no such thing. On the contrary, it indicates a stability -- in the face of depression conditions -- that may well be envied by any line of business or profession.

* * * * *

III. HAASE OBJECTIONS TO AGENCY COMMISSION ANALYZED;
ALSO LEGAL STATUS OF AGENCY AND RIGHT TO REBATE

Having attempted to prove that there is a general weakening in the agency structure, Haase asserts that the fault lies with the system of compensation -- the so-called commission system -- now in vogue.

Thus, at page 59, he says:

"Three observations stand out as unmistakable in the preceding chapters of this study: first, that advertisers have a vital need for the services that many advertising agencies are equipped to render; second, that they are availing themselves of agency facilities to a constantly decreasing extent; and third, that the greatest bar to a full use of agency service by advertisers seems to lie in the method by which advertisers are supposed to pay agencies."

And again, at page 60:

"It is the rigidity -- the hard-and-fastness -- of the discount system, with its rate set according to 1918 agency costs, which restricts the present-day agency in its usefulness to its clients. And it is the organized endeavor to make adherence to this minimum price-fixing device a matter of ethics which is forcing advertisers to find or to develop facilities to do what the agencies should be qualified and eager to do."

Haase's theoretic argument against the commission-system, and in favor of some undefined other system of compensation, is, as nearly as we can make it out, as follows:

The advertising agency is the agent of the advertiser and not of the publisher. (Pages 3 and 62)

Therefore it is the advertiser and not the publisher who ought to pay the agency for the service rendered to the advertiser.

It is in fact the advertiser who pays the agency -- for it is his money and the agency merely withholds its 15% before paying the balance to the publisher. (Page 3)

Since the relationship of principal and agent exists between the advertiser and agency, neither the publisher nor anyone else has any right to interfere in that relationship or to dictate in any way as to the method or amount of compensation the agency is to receive. (Page 4)

There can be no adverse interest as between a principal and his agent, and therefore it is not "rebating" if the agency passes on to the client part or all of the commission allowed to it (the agency) by the publisher on its purchases of space. (Page 4)

There is therefore no ethical or legal reason why the advertiser and agency should not make whatever arrangement, as to the compensation of the agency, that they can mutually agree upon. (Page 4)

* * * * *

Haase argues that the present method of compensation is wrong and should be changed for the following practical reasons:

1. It results in the agency's loyalty being divided between the advertiser and the publisher -- and, since the agency is the agent of the advertiser, it owes the advertiser undivided loyalty. (Pages 4 and 24)

2. It measures the value of services and ideas by the amount that is spent in advertising, rather than by either the value of the services and ideas, or the amount of time and effort spent by the agency in producing them. (Page 61)

3. Since the agency is given a commission on the amount of money spent, it gives the agency a selfish interest in the amount of expenditure; it makes it difficult, therefore, for the agency to make unbiased recommendations; it tends to cause recommendations for overspending, and for assigning to advertising too prominent a place in the entire marketing or promotional plan. (Pages 24 and 25)

4. Since the agency receives commission on certain kinds of expenditure, and not on others, it makes it difficult for the agency to judge impartially which media, and which kinds of advertising, to recommend. (Pages 24, 25 and 149)

5. Whereas the publishers claim that it is they who fix the amount of commission paid to agencies, and that this commission is paid for services which they consider valuable to them (the publishers), actually the rate of commission is fixed by the agencies themselves. This rate, being fixed on the basis of 1918 agency operating costs, is too inflexible to fit present needs, and should be adjusted in each individual case to fit the needs of that particular case. (Page 3)

X 6. Advertisers are compelled to pay for services they may not need or want in a level 15%. (Page 61)

7. While it is doubtless true that under the commission system now in vogue, the agency does not receive adequate compensation from the smaller accounts, the larger accounts are overcharged -- and that in turn leads to something else that may need to be corrected (Page 21); namely,

8. Agencies making too much money. (Pages 14, 15 and 16)

With some of the seven contentions thus advanced, no open mind would entirely disagree. Viewed abstractly, there would seem to be a number of valid objections to the commission system of compensating agencies. It does seem to give the agency a disproportionate financial interest in the amount of certain types of expenditure; it does seem to result in some of the agency's efforts

-- some campaigns -- being overpaid, and other efforts being underpaid.

If absolute perfection is to be the standard for a system of compensating advertising agencies, then the commission system does not qualify. It does not meet that requirement. The very fact that both advertisers and agencies are human, and subject to the normal frailties of humans, must deprive any system conceived by them and executed by them, of the attribute of being perfect.

But, as Grover Cleveland once said, we are confronted with a fact, not a theory. ^{They} ~~we~~ are engaged not in a Utopian search for something that cannot be found, but in trying to determine that method which, taken at large, will come most nearly to working out fairly, and equitably, and to accomplishing the objects that it is designed to accomplish. And in view of the growth of advertising not merely in volume, but also in effectiveness and technique, and in view of the contributions that advertising has made to the success of the advertiser, of the publisher and of the agency, ~~all operating under the commission system, it is reasonable to assume~~ ^{that abstractly} ~~that the agency structure, including the method of compensation, has been a constructive force.~~ ³¹ And of this the advertising and publishing interests are convinced, based on many years of experience.

Until someone can suggest an alternative method of compensation that will eliminate the admitted defects of the commission system, and at the same time not introduce difficulties and objections and evils of a far more serious character, we believe

every true friend of advertising -- whether he be advertiser, agency, or publisher -- will prefer to adhere to the formula which over a period of years has been attended with so practical a measure of success.

We have admitted that there are some human weaknesses in the agency compensation system, as is contended in the Haase report. With other of its contentions, especially regarding the agency's legal status and right to rebate, we must sharply disagree.

1. The Haase report predicates its main argument on a legal fiction that there exists, as between the advertiser and the advertising agency, an exclusive relationship of principal and agent. This is not the fact. The advertising agency is not solely the agent of either the advertiser or of the publisher, or of anyone else. The advertising agency is essentially an independent contractor, and has been so dealt with by both advertisers and media owners for decades. (Pages 62, 79, 80, 81 and 82)

To a very considerable extent the objections raised in the Haase report to the present method of compensation are based on the legal theory that the agency is, in law, the agent of the advertiser only -- and that as between the two, the technical legal relationship of principal and agent exists. Throughout the legal argument, complete reliance is placed on this contention; and, furthermore, the importance of the point -- in the minds of the authors of the Haase report -- is evidenced by the fact that out of the 215 pages in the report, no less than 53 (or nearly

one-fourth) are given over entirely to an attempt to prove the point.

As we shall point out later, we consider the precise legal relationship between the parties as being immaterial and inconsequential to the main point at issue -- rebating and the right to rebate. Nevertheless, we deem it important to clarify the true relationship between agency and client and to distinguish it from one upon which an unsound and untenable conclusion has been based in the Haase report.

Haase falls into two errors. He looks only at one side of the picture, when there are three sides, and then he substitutes legal fiction for the actualities of agency operation upon which any sound legal status must be based.

The agency's legal status, to the best of our knowledge, has never been authoritatively defined with any finality either by the courts or others, and in our opinion, can never be so defined because of the interrelated nature of the business -- a statement which is still true after studying carefully the legal argument in the Haase report. ~~However~~, the basis on which the ^{ad.} agency actually operates in dealing with both media and advertisers and is held responsible for its commitments to them, as a matter of course and of law makes of the agency mainly an independent contractor -- which engages in business on its own account and on its own capital; which enters into contractual relationships with clients, whereby it renders both professional and commercial services; which enters into contractual relationships with publishers, at

①
find all ad
one agency

its own risk and on the strength of its own credit, for the purchase of space.

In these respects the agency does not act as the agent of the advertiser. It contracts with the publisher for space -- and the publisher looks to the agency, not to the advertiser, for payment. If an exclusive relationship of principal and agent existed between client and agency, not only would the publisher proceed against the advertiser in case of default by the agency, but he could proceed only against the advertiser in any event. Not only would the "principal" be liable in such a case, but the "agent" would not be liable, even in the first instance.

What are the facts? They are clearly pointed out in a recent statement by the Periodical Publishers Association:

"For many years there have been frequent discussions of the question as to whose agent the advertising agent is in law. These have seemed to us to be academic and have not given due consideration to the actual practices in the business.

"The contention that he is (exclusively) the advertiser's agent has often been advanced. We, therefore, point out the established practices which preclude such a theory.

"....The agency, from its earliest days, has been responsible to the publisher for carrying out contracts and paying bills. All of its financial operations have been in line with this responsibility. Agencies have paid publishers large amounts, totaling millions, in fact, for space for which they were unable to collect from the advertisers. Agencies, not publishers, pass on the credit of the advertisers. Many agencies carry credit insurance for protection. When the agencies suffer credit losses, they either make good to the media owners, or become insolvent. This is entirely inconsistent with the theory that the advertiser is the principal and the agency his agent.

"....The publishers look only to the agency for pay. The Periodical Publishers Association regularly gets financial reports from the agencies and rates them for credit purposes. We do not collect from the advertiser in case the agency fails to pay."

Similarly, in a brief filed with the Federal Trade Commission in a case involving the agency system, the American Newspaper Publishers Association made the following pertinent statement:

"The word 'agent' as applied to the advertising agencies is a misnomer. Advertising agencies have never been agents in the true sense of that term. In the publishing field they are regarded rather as independent contractors soliciting advertising from the advertiser to be published in newspapers or other publications, procuring such advertising to be published, and receiving from the publisher a commission or discount from which, after the payment of their expenses, their profits are derived."

And in a New York case (Clegg v. New York Newspaper Union, 72 Hun. 395), the court said:

"He (the plaintiff) is described in the case as an 'advertising agent,' but he is neither an agent of the advertisers nor of the publishers. He makes agreements with those wishing to secure the publication of their advertisements to procure their publication in certain newspapers for certain sums, and contracts with the papers to publish the advertisements at rates agreed upon. The difference between the rate paid to the newspapers and the rate which he receives from the advertisers is his profit."

In endeavoring to establish that the agency is exclusively the agent of the advertiser, the study points out (Page 145) that there is no mention made of duties or obligations to the publisher

in the official Standards of Practice adopted by the A.A.A.A. at its convention in 1918.

Why should there be? The statement concerns merely the scope of work to be done in the conduct of an advertising campaign, the necessary steps to be taken in a well-rounded program of promotion. It in no way concerns the agency's relations or obligations to anybody.

The study also points out (Pages 159 and 160) that agency-client contracts make no mention of service to the publisher. Why should they? They cover only the services to be rendered the advertiser, disclosing merely to what extent commissions from media compensate the agency for service rendered to the advertiser. Obligations to the publisher are covered in a separate undertaking with him.

The study further points out, (Pages 160 and 161) that some agency-client contracts agree to act as the advertising agent of the advertiser. This seldom if ever has any legal intent. "Advertising agent" does not describe any legal relationship of principal and agent; it is merely a trade name commonly used to designate a concern engaged in rendering advertising service. The name is a misnomer and a senseless survival from the days when it meant a broker of space.

"It is clear," says Haase, "that the advertising agency, whatever its original function, has come to serve the interests of the manufacturer who advertises and may hold no other master before him." (Page 4)

The idea that an agent can serve only one master in a given transaction runs counter to common practice, recognized by custom and by law. Real estate brokers and life insurance agents serve both buyer and seller in the same transaction; this is also true of attorneys employed to represent both sides of a settlement, where the parties' interests are adverse. All the law requires is that the dual relationship be known.

The advertising agency is not exclusively the agent of the advertiser, nor of the publisher; it is essentially an independent contractor, as is further indicated by the following legal opinion rendered by Mr. George Link, Jr. of McKercher & Link, attorneys for the A.A.A.A. for many years, and intimately familiar with the obligations and operations of the advertising agency.

January 22, 1935

Mr. John Benson
American Association of Advertising Agencies
420 Lexington Avenue
New York City

My dear Mr. Benson:

I have analyzed the "Advertising Agency Compensation--Theory, Law and Practice" published by the A.N.A. and it contains many dogmatic and categorical statements relating to the legal relationships between the advertiser, the agency, and the publisher, which appear to be unsound.

The question as to whether an advertising agency is the agent of the advertiser, or the agent of the publisher, or the agent of both, or an independent contractor, can never be definitely judicially settled for the obvious reason that each case presented to the court is determined by the court upon the facts set forth in the particular case.

Since the decision of the court must be based upon the facts presented it follows that there will always be a variance of judicial determination of the relationship in different cases.

The facts are generally developed by individual transactions, contracts, letters, and conversations. Obviously no two state of facts are entirely similar. A sentence in a contract, a line in a letter, or a few words in an oral conversation, might compel a judge to arrive at a different conclusion than that arrived at in a prior decision.

There are some decisions which have held against our contention solely because of the use of the name "advertising agency." Fortunately our judges now go behind the name and examine the object itself, especially if the court's attention is drawn to the fact that the name is not descriptive of the object or relationship.

I have analyzed all of the cases mentioned in the report and with a few minor exceptions they do not even remotely touch the question of the advertising agency's relation to the publisher and/or the advertiser. In the few cases in which the relationship of the advertising agency to the publisher, or to the advertiser, is touched upon, there are special aspects of the case to obscure the question or the actual facts of agency operation have been misunderstood or ignored. This is easily accounted for upon an examination of the few court opinions relating to this general subject, nearly all of them decisions by the lower courts.

The leading case cited in the A.N.A. Report is Clegg vs. New York Newspaper Union, which the report states was decided in 1876 (see page 73). The case was decided in October of 1893. Therefore, the statement "the date is significant" (referring to the 1876 date as the alleged date of decision) is incorrect, whatever significance it may have.

The question of rebating was submitted to the court and jury as a sub-issue by the defendant, the New York Newspaper Union; using the language of the Court:

"On the trial the defendants contended that the plaintiff had violated the clause in the contract which provides that the plaintiff's orders were to be executed 'subject to the usual rules and regulations.'

"It was insisted that one of these rules provided that the plaintiff and all others engaged in the same business should not give their customers less rates than those prescribed in a schedule furnished by the defendants."

We must assume from the verdict that the jury decided that the plaintiff did not violate the usual rules and regulations, i.e. the rule against rebating.

The Court furthermore stated as follows:

"He is described in the case as an advertising agent but he is neither an agent of the advertisers nor of the publishers."

obviously holding that the advertising agency in question was an independent contractor.

The case of Dolman vs. United States Rubber Corporation of America, 288 Pacific Reporter 131, approves a fundamental rule of law, that any agent is entitled to reimbursement from his principal for all advances and expenditures properly made on behalf of the principal. But the legal status of the agency was not involved.

The Court wrote that the business of an advertising agency is somewhat out of the ordinary. Among other things, it wrote as follows:

"As to a newspaper, an advertising agency undertakes to solicit and finally prepare for insertion advertising matter and to collect therefor and then to pay the newspaper. In turn the newspaper gives to the agency liberal discounts on the payments which are made promptly. As to the advertiser, the agency undertakes to inform itself of its wants and needs and express them in the most effective form for insertion in a newspaper, to select the place in the newspaper where the advertisement is to be inserted, to obtain the most efficient and economical space, and make all arrangements therefor. On all of these matters it undertakes to be informed as fully as the proprietors of newspapers. Both as to the newspaper and as to the advertiser it undertakes to do perfect work. In the interest of the newspaper and also in the interest of the advertiser it undertakes to make payments promptly, obtain discounts for the prompt payments, and give the advertiser the benefit of the cheapest service possible."

At page 77 of the report the statement is made:

"There have been instances where, after an agent had bought advertising space upon a firm contract, the advertiser has elected to have another agent serve him. No cases have been found where a publisher has denied the right to an advertiser to effect a transfer of his account from one agent to another."

This question was directly involved in the Ayer vs. U.S. Rubber Company case. At the trial it was contended on behalf of the United States Rubber Company that there was a general custom in case of a change of agency that such reservations would be turned over to the new agency. The Court stated:

"Defendant offered evidence to show it was customary in the advertising business for the agent, when a contract was cancelled, to turn over all matters to his successor without charge beyond the date of cancellation of the

agreement. The trial judge rejected evidence of this custom on the ground that it failed to show the required uniformity to establish a custom, but, on the contrary, whether the alleged custom prevailed, depended on the circumstances of each particular case. In addition to the reason thus given by the trial judge, it is apparent that the parties, by their contract and letters, had expressly provided for the event which occurred by recognizing the right of plaintiff to be paid for services performed."

At page 30 of the report the following statement is made:

"The agent, in the language just quoted, is no longer the independent space jobber or space broker, but the business advisor and agent of the advertiser."

The case of *Kastor vs. Elders*, 158 S.W. 738 (Mo.) 1913 is cited in support of this statement. The Court quite strongly in its opinion intimates that the advertising agency is a middleman, which is synonymous with independent contractor. I use the language of the Court (underscoring ours) in support of this statement:

"The evidence shows that in the growth and development of the advertising business to its present large proportions, there has come to be what may be termed a middle-man or go-between, known as an advertising agent or agency. This man or agency deals with the advertiser on one hand, advising and assisting him in the selection of the publications to be used, having put in type and preparing advertising matter or copy; making or having made drawings, electrotypes, stereotypes, preparing letters, circulars, pamphlets and literature generally for circulation through the mails and otherwise; and generally conducting what is known as an advertising campaign -- while on the other hand, deals with the publications used, placing all orders for advertisements, and adjusting all charges and settlements with them, and paying all amounts due them. In fact, in such cases the publication deals with the agent only. The agent orders

the space, the same is charged to him by the publication at the card rate, less the agency commission or the agency rate, and he pays therefor, and the advertiser has no dealings with the publisher whatever."

Another case cited in the report is the case of *Hampton v. Schlesinger*, 99 N.Y. Supp. 528. This case was decided in 1906 and the Court held that in so far as the agency's contracts for space were concerned the relationship between that of the agency and the advertiser was that of an independent contractor and that the advertiser was not bound by the agency's contracts with the publisher.

The case of *Allen v. Pierpont*, 22 Fed. 582 (1884) can only be used as an authority for the moral and ethical proposition, to wit, in the language of the Court:

"The agent to buy property, who, in the pretended discharge of his agency, sells his own property to his principal, without his knowledge, is not entitled to commissions."

This case has no application to the modern advertising agency.

This same principle was followed in the case of *Hewitt & Hosier v. Lichty*, 126 N.W. 170; and *Hofflin v. Moss*, 67 Fed. 440. These cases, obviously, do not bear upon the present day relationships of an advertising agency to a publisher or to the advertiser.

The Court in *Hofflin v. Moss*, 67 Fed. 445, cited in the A.N.A. report, commenting upon the case of *Allen vs. Pierpont*, stated:

"In the case of Allen v. Pierpont, 22 Fed. 582, upon a contract like the one here in suit, the court held the plaintiffs could not recover, upon the ground that they were agents, under the contract, and had not acted in good faith towards their principal; and their action was the same, in all respects, as the action of the plaintiff in this case. The judgment of the circuit court is reversed, and the cause remanded, with directions to grant a new trial."

Again indicating the fact that the cases cited in the A.N.A. report are not precedents which have any value in the advertising agency relationship to the publisher or advertiser as it exists this day.

In the case of Rosenbaum v. Sarasohn, 171 N. Y. Supp. 629, the Court held first, that an advertising agency may be the agent of the publisher and also of the advertiser, rendering an important and valuable service to each and, without making a disclosure that he was receiving commissions from both, he is legally entitled to receive commissions from both the advertiser and publisher.

The case of Montague v. All Package Stores, 169 N. Y. Supp. 920, involves a special and unique arrangement, one not based upon the customary method of doing business in the advertising agency industry. The defendant was both publisher and advertiser, and no commission relationships were involved. This is illustrated by the following extract from the opinion of the court:

"It is quite evident that this arrangement did not contemplate that the defendant (McAtamney Co.) should become an independent contractor for the publication of the Weekly. On the contrary, it is clear that he was to become merely the agent of the plaintiff (The All Package

Stores Co.) incurring bills on plaintiff's account and receiving the necessary moneys from plaintiff to meet them."

None of the precedents similar to this precedent, cited in the A.N.A. report, are helpful because they do not involve the normal relations between agency and advertiser or between agency and media owner.

The question raised by the case of Clarke v. Watt 145 N.Y. Supp. depended upon a question of fact as to whether or not credit was given to the advertising agency or to the advertiser. Two of the judges were of the opinion that under the facts set forth in the opinion the advertiser alone could be held responsible and not the agency, while Judge Lehman in a dissenting opinion held that the advertising agency was solely responsible to the publisher based upon his conclusions, to wit, that the publisher relied solely upon the agency for the payment of his bill for space used by the client of the agency. Judge Lehman is now a judge of the Court of Appeals of the State of New York and he is considered one of the ablest judges now on the bench in the United States. In any event the case of Clarke vs. Watt was, in effect, overruled in the following year by the case of Hoffman vs. American Tobacco Company in which the Court held that the publication must look to the agency for the payment of the space contracted for by the agency and not to the agency's client, indicating conclusively that in the Court's opinion the agency is an independent contractor.

Faithfully yours,

(Signed) George Link, Jr.

2. But the precise legal status of the advertising agency is entirely beside the point. Even if it were to be conceded that the agency is the agent of the advertiser, there is nothing immoral, illegal, inconsistent, or anomalous about the present method by which the agency receives its major compensation.

It becomes necessary at this point to clarify the relationship between the agency and advertiser on the one hand, and between the agency and the publisher on the other.

First of all, let it be said that there is no disagreement with the contention that the agency owes undivided loyalty to the advertiser within the limits of honesty and professional practice. As to the matters entrusted to the agency by the client, -- just as by a client to an attorney -- a confidential, fiduciary relationship exists; and in respect to those matters, the agency owes to the client not only professional allegiance as against any third parties, but complete disclosure to the client of any facts that might by any possibility tend to create an adverse interest.

But here is an important distinction that seems completely to have escaped Haase. He lays great emphasis on the fact that as between the advertiser and agency there must be no "adverse interest." (Page 33) But he fails to differentiate between the matters in which there must be no adverse interest and those as to which, in the very nature of commerce, there has to be an adverse interest. In dealings with third persons -- including publishers -- there must be no undisclosed adverse interest; and in dealing with

the subject-matter of the relationship -- the advertising problems of the advertiser -- there must be no adverse interest; but in respect to the contractual relationship between the advertiser and the agency, there is bound to be an adverse interest. And this is equally true whether the relationship of principal and agent exists or not; it is true as between physician and patient -- it is true as between client and attorney -- it is true as between trustee and beneficiary -- it is true in any case where the relationship is a contractual one. In respect to the agreement between the parties, they are not dealing as parties of identical interest, but as parties of opposing interest. It is only when the relationship has been established, and only in respect to the matters with which the relationship is supposed to concern itself, that the unity of interest -- the confidential relationship -- comes into being.

Haase seems to resent that the agency should receive compensation from the publisher -- a party whose interest is adverse to that of the advertiser. But he seems to forget that, since the arrangement is open and above-board, fully known to all parties at the time the relationship is entered into, it is not only not inconsistent with or repugnant to the obligations of an agent, but becomes an integral part of the client-agency relationship.

Haase insinuates that the present arrangement gives the publisher an unwarranted voice in determining the relationship between the advertiser and his agency; that it permits the publisher to interfere with the advertiser's right to compensate his agency as he sees fit.

Here again, Haase ignores the true situation.

No one, as far as we know, questions the right of the advertiser to compensate the agency in any ethical way, that he and the agency may find mutually satisfactory. But neither, we think, should anyone disagree with the right of the publisher to sell his space on whatever basis he deems advisable; to determine the price at which he shall sell it, to determine whether and to what extent the existence of a successful, sound agency system contributes to the health and ultimately to the profitableness of his business; to determine whether and to what extent he wishes to contribute to the continuation of that system by allowing to certain constructive forces, compensation in the form of a commission.

Publisher's Vital Need of Agency Service

The publisher's position -- and we think it is not only inherently sound, but that it squares with existing practice -- is substantially this:

1. Advertising is the very lifeblood of his business and his profits. Without advertising he would have to collect a much higher price for his publication -- so much higher, in fact, that its circulation would be drastically restricted. (And, incidentally, without the volume of circulation which is made possible by the low sale price of the publication, which in turn is made possible solely by advertising revenue, the publication would be of vastly less value to the advertiser -- since it would tap a much smaller market. Thus not only the publisher's profits, but the advertiser's interests -- so far as they are dependent upon advertising -- are vitally concerned with the success of the institution of advertising, as a whole.)

2. Whatever stimulates the legitimate use of advertising, therefore, is of value to the publisher. And since nothing stimulates the increased use of advertising like the success of advertising, the publisher has a vital interest in seeing to it that advertising expenditures and advertising campaigns be made to produce for the advertiser to the very utmost. Only in this way will the advertiser be encouraged and enabled to spend more money in advertising; and only in this way will the non-advertiser be made to see the advantages of advertising, and be caused thereby to become an advertiser himself.

3. To be successful advertising, it must be good advertising -- soundly conceived, as to the job to be done, the resistances to be met and overcome, the markets to be tapped, the amount that can be economically spent in view of probable returns; soundly executed, as to appearance, as to selling appeal, as to copy treatment, as to truthfulness and fairness toward competitors, as to its helpfulness to the reader and prospective consumer. Neither the publisher nor the average advertiser -- whose principal job is the production and selling of his merchandise -- is equipped to bring to bear on advertising problems the expert, highly specialized ability, and varied experience that is necessary to produce this successful kind of advertising.

4. The agency, as it has evolved from the embryonic stage of a century ago, provides this service -- and is therefore a constructive force tending to insure the success of, and thereby perpetuate and increase the use of, advertising. Irrespective, therefore, of its specific value to the advertiser -- which of course has not been denied, but which is not relevant to this particular point -- the advertising agency is rendering a service which is of inestimable value to the publisher.

5. And since the publisher is convinced that the success of advertising depends upon the continued existence of a group of strong, well-financed, experienced, able, and ethical advertising agencies, and since he is convinced that the welfare of his business depends on the success of his advertisers; nothing could be more natural than that he should wish to provide -- and insist on providing -- for a continuation of that system.

6. Just as the automobile manufacturer fixes the commission to be allowed to his dealer on the basis of what is required to make a dealer operation profitable, just so the publishers have sought to keep their agency commission at a minimum level which would make the agency

business reasonably profitable to the kind of men whom the publishers believe the business needs.

7. In effect the publisher says to the advertiser:

"I have space to sell. In my own interests, it is important that that space shall be used intelligently and effectively. I am no longer able -- as I was once -- to 'service' that space for you. Frankly, most advertisers are not equipped to do it, either. Therefore, I will sell you the space -- and if you wish it, I will provide for you the services of a group of experts who will serve you (so far as the use of my space is concerned) without any compensation from you. I will pay them out of my gross receipts for space. And please note: you are not limited in your choice of agency: you may choose any agency you want, provided it conforms to my standard of what is best for advertising and therefore for me. And in serving you, as your advertising agency, it will be working directly for your interests -- and only indirectly for mine. Because it continues to receive compensation from me -- in the form of a commission -- only as long as it satisfies you. Its value to me depends on what it does for you. Therefore, while its services are not paid by you, it is answerable to you -- it must satisfy you that it is loyal to your interests -- it must satisfy you that it is rendering you at least as good and effective service as you could obtain from any other agency -- it must sell goods for you. If the agency does all of those things, I shall have my reward in the continuation of and the increase in the business that you place with me.

"But if you say that you have no need for an agency, but prefer to buy directly from me, I say that I have no objection whatever to that. I may question the wisdom of most advertisers' doing that; but I by no means question their right to do so. But if you say that, since you do not require the services of an agency you should therefore have the right to buy from me at the net rate that I realize when I sell to an agency, I cannot agree.

"The agency system is here. It is made available, because of its importance to advertising generally and to my business specifically, for all advertisers who wish to take advantage of it. And it would obviously not be sound, or in the interest of that system, if we should sell directly to the advertisers at the same rate as we sell to the agencies.

"You, perhaps, are an automobile manufacturer. You believe -- whether rightly or wrongly -- that the success

of your business depends on your having a strong dealer organization; dealers whose salesmen can relieve you of the job of calling on retail prospects; dealers who can relieve you of the heavy investment that would be needed if you were required to maintain all the retail automobile showrooms in the country; dealers whose efforts aid tremendously in building the volume sales which alone make possible the low prices of today, thereby benefiting the consumer in far greater measure than the amount of the dealer's discount; dealers who are prepared to service the automobile when once it has passed into the consumer's hands. And for these reasons you build and maintain a dealer organization -- adjusting the discount from time to time, not on the basis of what you may think of the value of the service rendered by an individual dealer, but on the basis of what it costs -- on the average -- to operate profitably the kind of dealership you think is required for the benefit of the automobile business, and specifically for your business. If operating costs go up -- or volume goes down -- so that you find too large a percentage of your dealers failing, and there is no longer any incentive for the right kind of men to come into your dealer organization, you increase the rate of commission. In the opposite event, you decrease it. It is imperative that you maintain a strong dealers' organization -- and over the long pull, and taking the group as a whole, it is important to you that they make a profit.

"Occasionally, no doubt, a prospective customer comes to you who wants to buy an automobile 'without benefit of dealer.' He requires no salesman to sell him your automobile -- he knows all about it; he wants it. He is a mechanic himself, or perhaps he has his own chauffeur; therefore he will have no occasion to call upon the service facilities maintained by your dealer for his benefit and the benefit of all users of your automobiles. In other words, he requires no help from your dealer of any kind. And therefore he wants to buy from you at the same price at which you would sell to your dealer.

"And why not? You will make your regular profit on the transaction -- because you will have received exactly the same price that you would have received if the car went through your dealer's hands. Your dealer will be nothing out -- because he has rendered no service and will be called upon to render none.

"Yet I suspect I know what your answer would be. You would say, 'Sorry, but I can't do it that way. True, in this particular case, no one would suffer. But I need

my dealers. My business could not live without them. They are there to serve my customers, and thereby to serve me. And if merely because in some individual cases the customers do not choose to avail themselves of the service that is there waiting for them, I cannot sell those customers on a basis that would tend inevitably to break both the morale and the structure of my dealer organization. You may buy from me if you wish; but you will have to pay exactly the same price as if you were to buy through the dealer. In no other way can I assure the permanency of organization on which my business depends, and I might add that the same breakdown would result if dealers were permitted to share any part of their commission with customers or to dicker with them about that fixed percent of compensation. They would soon trade themselves out of solvency and credit and demoralize the dealer franchise to a point where able men would withdraw.

"The fact that some of my dealers, exceptionally placed or of unusual ability, make a larger gross income at the standard rate of commission than needed to maintain the service I require, would hardly condemn either the rate or the method in general effect for all dealers. Greater risk and greater ability should be proportionately rewarded. If this were not true, then again I would lose my best dealers."

While the functions of a dealer and of an advertising agency are not parallel in all respects, they are parallel in respect to making and sustaining the market for a product or service by creating customers and then by satisfying or serving them. In both cases the commission acts as an incentive to creative effort.

What the publisher is selling is space. The services rendered to the publisher by the agency -- and here again is where there has been too much fallacious reasoning -- consist not primarily of specific services to a given publication but of the contributions which a stable agency system makes to the success and permanence of advertising, and thereby to the publishers whose business is dependent upon advertising.

Why Agency Has No Right to Rebate Commission

The Haase report takes up the cudgels strongly in favor of the right of the agency to do what is generally called "rebating" (Page 33): that is, passing on to the advertiser part of the commission that it receives from publications. Haase's defense of the practice is based on the contention that since the agency is the legal agent of the advertiser, and since therefore there can be no adverse interest as between the advertiser and agency, there can be no such thing as "rebating."

This reasoning is legally and morally unsound, because it does not square with the facts and fails to distinguish where "adverse interest" applies. As far as the latter point is concerned, it has been demonstrated in the foregoing pages that, regardless of whether the agency acts as the agent of the advertiser, there is an adverse interest in all negotiations or contracting between them including, of course, any agreement to rebate.

In taking the position that there can be no rebating, in a legal sense, between agency and client, Haase is also flying in the face of the public policy of both Federal and State laws.

Quoting from a legal opinion of our attorneys, McKercher & Link, written under date of December 4, 1934:

"I am reading the Advertising Agency Compensation study made by the Association of National Advertisers, Inc. I am perusing it very carefully as it indicates that those who prepared the legal background for the report spent many months in so doing.

"As a preliminary comment which will indicate to you the

unsound premise upon which the legal part of this report has been founded I would like to comment immediately upon the following quotation appearing on page four of the report:

'The true meaning of the word "rebate" this study shows is this: A rebate is an arrangement between parties of adverse interest.

'After considering this fact, let it be pointed out that legal research definitely fixes the modern advertising agent as the agent of the advertiser and as owing undivided loyalty to the advertiser unless the advertiser specifically contracts for some other relationship with the agent.

'All of this being so, it follows that where undivided loyalty is called for there can be no adverse interest. Since there can be no adverse interest in law, between advertiser and agent, there can be no "rebating" between them.'

"The attorney who wrote or inspired this paragraph disagrees with the legislative policy of the United States and also the State of New York and many other states. By way of illustration, the people of the State of New York through their law-making body have prohibited and made it a misdemeanor for an insurance agent to share his commissions with his insured, the principal. If, as the author of the above quotation states, there can be no rebating between an agent and a principal, he must take his stand against all of the law-making bodies of the states that have enacted this very salutary law.

"Our courts have repeatedly held that in negotiating for a policy on behalf of a person desiring insurance the broker is the agent of that person and not of the insurance company.

"The Federal law makes it a misdemeanor for the carrier to grant to a consignor a rebate from its published rates and also makes it a misdemeanor for the consignor to receive such rebate. The penalties are severe. The relationship between a common carrier and the consignor is what is legally defined as the relationship of bailor and bailee having many aspects of the trustee relationship referred to in the A.N.A. study. This law sets

forth the public policy of the United States with particular reference to its understanding of the term rebating which also disagrees with that of the author of the above quotation.

"You will observe that the cornerstone for the legal portion of the A.N.A. report is founded upon quicksand, which will speedily engulf the argumentative portion of the review.

"George Link, Jr."

Aside from any legal theories on the subject -- there are actual obligations in effect between agency and media owners, upon which both moral and legal rights must depend.

The practical question is whether, regardless of any relationship between agency and client, the agency has any right -- in view of the known terms of the arrangement under which the publisher has accorded it commissions -- to violate that arrangement by passing them on to the advertiser.

It seems to us that the mere statement of the question provides the answer. If the publisher has the right to determine to whom and under what conditions he shall grant a commission on his card rates; if he has stipulated, as one of the conditions of the granting of that commission to accredited and recognized agencies, that they shall not use it -- in whole or in part -- in such a way as to violate his published rate card; if the agency has applied for, and accepted, "recognition" from the publisher and has accepted the proffered commission with full knowledge of those terms and conditions; then of course the agency is bound by every consideration of decency and honor not to violate the understanding.

And, as suggested before, this is equally true whether the

agency is the agent of the advertiser or not.

Even if he is such an agent, the principal has no right whatever to induce him to violate an agreement which the agent has made, with full knowledge of the principal. And neither is there anything wrong, either in law or morals, in the agent's entering into such an agreement in the first place -- provided only that the existence and the terms of the arrangement be disclosed to the principal. The advertiser's knowledge of the arrangement is the vital factor. And of course no one even suggests that the arrangement under which publishers compensate agencies with a commission, and prohibit the passing on of that commission to the advertisers, is not thoroughly known and understood by advertisers.

Rebating, call it what you will, is a practice which publishers are entitled -- in the interest of their own business -- to prohibit. It is a practice, call it what you will, which agencies have no right to engage in. It is dishonest and violates both legal and moral obligations.

Of course any advertiser has the right to decline to deal with an agency on the basis of its receiving commissions from media owners on his business; and the agency can forego such commissions if it so elects. But no agency has any right to play fast and loose with the equities of a third party, in accepting a commission from him and then disposing of it contrary to agreement.

Does Agency Commission Induce
Either Overspending or Biased Spending?

It is charged by the study that the commission system results in recommendations for overspending -- and for choosing commissionable media as against non-commissionable forms of advertising. (Pages 24, 25 and 149) This is theoretically possible, but practically the advertiser is protected against it, as would be true of any other form of compensation, by the checks and safeguards which competition and business necessity impose.

1. In the first place, it is doubtful whether any appreciable number of advertising agencies would be so unmindful of their own best interests as to make recommendations based on an immediate selfish gain as against their clients' need or advantage.

2. Furthermore, clients are not so naive that they would accept readily recommendations which did not make good business sense. Certainly they would not be likely to do it a second time -- with the same agency. Their natural instinct would be to oppose such excesses. There is far greater danger, in fact, of underspending, with the inevitable result of inadequate returns.

As a matter of fact, it is an ideal relationship to have the agency financially interested in finding new ways and means of promoting the client's business, through expanded advertising -- and the client, on the other hand, as a buyer, conservative and critical in his own protection. It is through such teamwork that any undertaking as promotive as advertising becomes most successful.

3. Competition among agencies can be relied upon to apply the necessary pressure on agencies -- to the extent that external pressure is needed to make their efforts productive for clients; first, in order to enable them to retain the business; second, to make it possible for the clients soundly and economically to spend more money for advertising, thereby benefiting the agency; and

third, to establish a record for success which is and should be the most effective competitive weapon the agency can have in soliciting new business.

If motives of self interest should all fail to keep an agency loyal to a client's best interest, the advertiser still has an effective means in his own hands, of securing impartial recommendations in the selection of commissionable as against non-commissionable media or other promotive channels. He is in a position to remove temptation from his agency by paying it proportionately for handling those forms of expenditures that are non-commissionable -- a practice now very common.

Under such an arrangement, the advertiser would -- as now -- pay the agency nothing for its service in handling advertising in commissionable media. Compensation then, as now, would come to the agency in the form of commissions from the publishers. But on all other expenditures -- for direct mail, store display, premiums, sampling, trade and consumer deals, trade magazines -- as to which the critics of the present system fear that the agencies are inclined to be too unfavorable, a commission paid by the advertiser on the actual expenditures would remove the temptation to be venal. Many agencies now work on such a basis.

Would a Fee System Remove Such Temptation?

As a corollary to the theory that the agency commission tempts advertising agencies to prefer "commissionable" billing, some

opponents of that system assume, as does the study itself, that a "fee" system of compensation would remove that temptation.

On page 64 the study remarks that if a flexible arrangement for compensation were made, it would "bring about more effective advertising because the agency would be interested in only one thing - making the advertising of the client as profitable as possible." This is fallacious.

Whatever may be said of the theory that the commission puts too much of a strain on the honesty and common sense of the agency, it may be said without any hesitancy that the answer is not to be found in a fee system of compensation. In fact, any belief that a change in method of compensation would assure disinterested and unselfish recommendations from an advertising agency blind enough to be concerned only with its immediate reward, is rather naive.

The fallacy of such reasoning lies in the failure to recognize obvious facts in advertising and in human nature.

Even assuming that fees, as perhaps many advertisers believe, would be based in large measure upon the kind and amount of work done by the agency, there would always be some forms of promotional activity which lead to greater compensation or more profit for the agency than could be expected from alternative channels or methods.

The agency would still be tempted to recommend the kind and amount of work which secured for it maximum employment of the facilities it had to offer.

Let us illustrate the point by calling attention to certain

hypothetical situations, each of which presents a choice between two or more promotional alternatives.

1. Suppose a case in which the question involved is one of pricing-policy: Shall the price be reduced, and advertising expenditures curtailed, or shall the price be maintained and advertising expenditures increased? This is by no means an unusual situation. It occurs, and with some frequency. If the advertising expenditure shrivels the agency naturally would receive less compensation -- whatever the method of computing it. The only way to be sure of getting an honest, disinterested, and intelligent recommendation from an advertising agency on this kind of question is to be sure that the agency is honest, disinterested and intelligent. No fee system will provide that assurance.

2. Or suppose that the question is between publication advertising, on the one hand, and a consumer premium deal, on the other. Or between advertising and a free deal to the trade. In one case the agency will be called upon to render service which must be paid for in some way -- either on a commission basis or with a fee; whereas in the other, the agency might be called on to render little or no service, and earn little or no compensation. If the opponents of the present system are correct in their estimate of agency honor, the larger fee would tempt the agency to recommend against the premium deal, against the trade deal, and in favor of advertising. Switching to the fee system would not obviate that.

3. Or suppose the question be whether the money available for promotion can most profitably be spent in advertising, or by increasing the intensity of the sales effort -- the addition of more salesmen, the employment of higher-paid salesmen, the inauguration of a training school for salesmen. If the one alternative is adopted, there will be much work for the agency to do -- and it will be compensated, either by a fee or otherwise; if the other alternative prevails there might be little or nothing for the agency to do -- and it will be paid accordingly. Payment of a fee would not remove the temptation -- if temptation there be -- to recommend a course that will make work, and therefore, compensation, for itself.

Similar situations occur in other professions. Take the medical profession, for example -- or the legal profession.

No one doubts that the lure of a fat fee has influenced some doctors to recommend operations for appendicitis, when far simpler and less expensive treatment might have been just as good or better. Nor that now and then a money-minded, short-sighted lawyer will recommend fighting a case through the courts, actuated solely by the knowledge that such a course would mean a bigger fee to him than if the case were settled amicably.

Fortunately, in law and medicine as in advertising, the practice is by no means common. But the point is that in law and medicine -- as in advertising -- a fee system does not correct whatever evil there is.

All human experience shows that honest and sound advice does not depend on any method of compensation. It depends essentially on the person giving it -- how honest and intelligent he is. In this respect, advertising is no different from any other business or profession. If an agency cannot be trusted to look beyond its immediate selfish gain, to the more substantial reward that comes from a service honestly and efficiently rendered, the remedy is not to change the method of pay, but to change the agency to one that can be trusted.

* * * *

So much for the theory of agency loyalty to client: What's the record of agency performance in this regard, under the commission system?

It is widely recognized by everybody, that agencies nowadays bend every effort to make the advertiser win; use every available means, whether profitable to them or not; employ the most effective channels within their knowledge and experience. Success depends upon it.

In their zeal to serve advertisers, agencies have at times forgotten to be decently fair to the media owner and even to protect advertising itself against abuse. They frequently fight publications for rates and deals which undermine their own title to commission.

Agencies freely use media which allow no commission to them, such as many business papers and practically all newspapers on national advertising placed at local rates.

Are Agencies Overpaid?

An important question that remains for consideration and after all, the one most vital to the economics of agency operation, is this:

Are agencies overpaid, under the present arrangement; or, putting it another way, are advertisers being overcharged for the services being rendered by the advertising agency?

The Haase report throws little or no light on this question. In fact, the contribution of the Haase report towards it is confined to the following: (Page 16)

1. A quotation of figures compiled by John Benson, President of the American Association of Advertising Agencies, showing that the 59 members of the association furnishing figures for 1925 had reported an aggregate net profit equal to 2.65% on their aggregate billing.
2. The assumption, "based on personal experience," by E. T. Gundlach that the net profit figure is approximately 5%.
3. An unsupported statement by Kenneth Goode, likewise stating that net profits equal 5% of the billing.
4. A claim that profit figures, without co-incidental figures showing principals' salaries, are without significance.
5. The statement that the practice of figuring net profit against total billing is fallacious, since it is only the 15% that constitutes the agency's gross income. Figuring the ratio of profit to gross income on this basis, Haase finds the net profit to range from 13% to 33-1/3%.

Of the specific figures offered, only the first quotation purports to be anything more than an expression of opinion. The fact that 59 representative agencies -- accounting for billing aggregating \$104,000,000, or an average of more than \$1,750,000 each -- showed net profits of less than 3% is definite and concrete evidence from an authoritative source.

Since the above figures covering average net earnings were reported in 1925, cost and profit figures for members of the A.A.A.A. have been compiled over a period of years and they make a

far less attractive showing. For instance, during the five years from 1929-1933 inclusive, the showing for net profit covering a majority of the membership, was as follows:

1929 net profit	1.4% of volume
1930 net profit	.8% of volume
1931 net profit	.06% of volume
1932 loss	1.0% of volume
1933 loss	.3% of volume

Thus, in the peak year of 1929, average profits fell well below 2%; in 1930 and 1931 they were less than 1%; in 1932 and 1933 there was a deficit.

As an indication of how many of the reporting agencies earned 2% or more, and how many earned 3% or more, we quote the following figures taken from A.A.A.A. studies of membership earnings:

<u>Year</u>	<u>Agencies Earning 2.0 or More</u>	<u>Agencies Earning 3.0 or More</u>
1929	15 out of 41	7 out of 41
1930	14 out of 57	8 out of 57
1931	11 out of 63	4 out of 63
1932	3 out of 57	0 out of 57
1933	6 out of 64	2 out of 64

In Haase's study, he quotes a breakdown of the 15% agency commission taken from a book published by George H. Sheldon in 1925, and implies that the figures represent an average situation, where- as Sheldon specifies that they apply to a hypothetical business of \$4,000,000 a year. These figures show a net of 2%. (Page 15)

To indicate how average figures of agency overhead and net profit have since varied from that ideal case, we quote below a breakdown of the 15%, based upon actual figures furnished by A.A.A.A. members during the years 1929-33 inclusive. From this comparison, it will appear that the net profit shrank from the Sheldon hypothetical figure of 2.0% to .2% in actual practice.

<u>Classification of Costs</u>		<u>Sheldon Hypo- thetical Figures</u>	<u>A.A.A.A. Actual Figures</u>
(Sheldon)	Creative and Contact	8.4	
(A.A.A.A.)	Contact, Copy, Visualization		8.2
(Sheldon)	Research	1.3	
(A.A.A.A.)	Research		.7
(Sheldon)	Media, Rates, Checking - and Accounting	1.5	
(A.A.A.A.)	Rates, Media - and Accounting, Billing and Checking		1.8
(Sheldon)	Mechanical Production	1.0	
(A.A.A.A.)	Mechanical Production		1.0
(Sheldon)	Administrative	.5	
(A.A.A.A.)	Executive Overhead		1.4
(Sheldon)	Solicitation	.3	
(A.A.A.A.)	New Business		1.7
(Sheldon)	Net Profit	2.0	
(A.A.A.A.)	Net Profit		.2
TOTAL		15.0	15.0

Of course, it is perfectly true that net profit figures have a limited meaning -- in a business such as the advertising agency business -- unless read in connection with the emoluments obtained

from the business by the principal owners in the form of salaries, bonuses or otherwise.

The Young report offers the only factual evidence available on this point.

The following table, found at page 138 of the Young study shows the "estimated average individual income received by or accruing to agency principals from agency operations."

TABLE XLIX
ESTIMATED* AVERAGE INDIVIDUAL INCOME RECEIVED OR ACCRUING TO
AGENCY PRINCIPALS FROM AGENCY OPERATIONS

Amount of Agency Billing	1928		1929		1930		1931		1932	
	Number of Principals	Average Income of Group	Number of Principals	Average Income of Group	Number of Principals	Average Income of Group	Number of Principals	Average Income of Group	Number of Principals	Average Income of Group
Under \$250,000	9	\$ 4,400	7	\$ 3,900	13	\$ 4,700	18	\$ 4,800	27	\$ 2,600
250,000 to \$ 500,000	21	9,500	20	9,700	12	10,700	28	8,300	37	7,300
500,000 to 750,000	23	16,200	34	12,200	34	12,900	26	10,700	16	4,900
750,000 to 1,000,000	28	12,800	18	12,500	20	15,900	19	9,000	21	10,900
1,000,000 to 2,000,000	24	19,600	32	20,400	47	16,600	38	17,000	34	8,000
2,000,000 to 3,000,000	12	38,400	13	33,400	6	34,000	11	19,300	10	36,000
3,000,000 to 5,000,000	33	36,000	21	42,800	17	21,600	27	20,000	23	19,000
5,000,000 to 7,500,000	19	66,800	23	69,200	25	59,700	9	56,000	2	115,500
7,500,000 to 10,000,000	33	120,000	10	84,400	10	60,000	43	64,000	43	45,700
10,000,000 and over	33	120,000	33	101,600	32	77,000	43	64,000	43	45,700

* This estimate was made by applying the percentages from the preceding table to the volume and arriving at an estimated total dollar income of the principals group. This was then averaged by all the principals in all agencies in the same size groups. Volume was estimated for all size groups, except the highest and lowest, by taking the middle figure in the volume range. For the lowest group an estimated average volume of \$122,000 was taken. For the highest group approximate actual volume was known.

James W. Young Advertising Agency Compensation (1933)
Reprinted by permission of the University of Chicago Press

And on page 131 of the same report we find a tabulation of the number of account executives in the various income brackets:

TABLE XLIV
NUMBER OF ACCOUNT EXECUTIVES WITH TOTAL AGENCY
INCOMES IN DIFFERENT SIZE GROUPS
Includes three highest paid (other than principals) among various agencies.

AMOUNT OF INCOME RECEIVED	NUMBER OF INDIVIDUALS RECEIVING				
	1928	1929	1930	1931	1932
Under \$5,000.....	25	21	21	27	40
\$ 5,000-\$ 9,999.....	33	45	46	41	40
10,000- 14,999.....	21	14	23	26	19
15,000- 19,999.....	18	20	17	16	15
20,000- 24,999.....	6	9	8	1	4
25,000- 29,999.....	4	4	2	5	1
30,000- 34,999.....	1	4	3	.....	2
35,000- 39,999.....	2	.....	3	5	2
40,000- 44,999.....	.....	2	1	.....	.....
45,000- 49,999.....	.....	1	3	1	.....
50,000- 54,999.....	1	2	.....	1	.....
55,000- 59,999.....	.....	.....	.....	.....	.....
60,000- 64,999.....	1	.....	.....	.....	.....
65,000- 69,999.....	1	.....	.....	.....	.....
70,000 and over.....	.....	.....	1*	.....	.....
Total.....	113	122	128	123	123

* \$88,826.

James W. Young Advertising Agency Compensation (1933)
Reprinted by permission of the University of Chicago Press

Each reader will have to judge for himself whether the figures just quoted, taken together or separately, indicate either excessive profits or inflated salaries for agency service. Examined in the light of compensation for comparable ability in other lines of endeavor they seem to us reasonable. And this is particularly true when we take into consideration the following facts:

1. While it is perfectly true that the agency business consists primarily of rendering service -- and that therefore the principal investment is in personnel and in brains -- it must not be overlooked that there is in addition a substantial investment of capital in the sense of cash. In this respect the agency business is quite unlike the "business" of practising law or medicine or the other professions; because, since the agency does assume definite financial obligations, it requires capital in direct relationship to the amount of billing. A.A.A.A. standards require that an agency doing a monthly billing of \$20,000 have net current assets -- not total capital, it will be noted, but net current assets -- equal to 100% of the monthly billing; and that in the case of the largest agencies -- with billing of \$250,000 per month or more -- the net current assets should be at least 40% of the monthly billing. Thus an agency doing \$10,000,000 per year would require \$333,333 in net current assets, as a safe operating minimum, but as an ample limit for taking care of unforeseen credit losses, or abrupt expansion of volume, the net current assets should, in the opinion of the A.A.A.A. Finance Committee, always be 100% of average monthly billing, regardless of its size, in this case \$833,333.

2. It is entirely fair and logical to figure net profits on the basis of total billing -- because that is the amount of credit risk assumed by the agency and measures the volume of expenditure for which it is responsible to the client. It is not logical to figure net profit on a gross income base, as claimed by Haase. But this difference really does not matter. It is theoretical. The practical question is simply this: "Is even \$26,300, for instance, in a prosperous year, too much profit to make on an annual billing of \$1,000,000?" (Based on rate of net profit reported by A.A.A.A. members in 1925 - page 54).

3. As pointed out in the Young study, the income of an agency is subject to violent fluctuations -- absolutely beyond the control of the agency; abrupt reductions in the advertising appropriations of clients, which cannot promptly be reflected in a corresponding reduction in agency expense -- rent, and other overhead expenses particularly, but also salaries which can by no means be immediately adjusted to the reduced agency revenue; loss of business, always a threat in so highly competitive a field as advertising agency service; the necessity for the addition of new services, or the expansion of existing services, due to new developments -- such as for example, the trend toward more exhaustive copy-testing, the installation of radio personnel without any corresponding increase in total revenue, and the like.

From the standpoint of earnings by agency-owners or agency-personnel, we do not think that the compensation is excessive, for the skill and risks involved.

How, then, does it look from the obverse side of the picture -- namely, from the standpoint of cost to the advertiser?

First of all, it is very difficult to say just what agency service, aside from fees and extras, does cost the advertiser. That it does cost something is not improbable, for if the publisher did not give the agencies a 15% discount, it might be possible for him to make some reduction in rates. But this is by no means certain. Leading publishers contend that the agency system actually results in lower rather than higher rates for their space; that if the agencies were eliminated, the cost to the publisher of doing the things of which the agencies now relieve him would exceed the 15% now allowed the agencies in the form of a commission; and that the elimination of a direct financial incentive to agencies would result in less advertising, and in less effective advertising,

necessitating an actual increase in rates.

The advertiser, contrary to what some people assert, is not taxed 15% for the service rendered by his agency. If the one contention by publishers is accepted, he is charged nothing; at the very most he is charged substantially less than 15% for the best advertising service that money can buy. It cannot be said that the advertiser, in the vast majority of cases, is being taxed too much for that service.

Does the Advertiser Pay the Agency Commission?

Haase claims (Page 3) that it is not the publisher who pays the agency commission, but the advertiser, because all the money flows from the advertiser to the agency and thence 85% of it to the publisher.

That argument is very superficial, based on the mere mechanics of payment. The 15% obviously comes out of media income and in case it were abolished as a commission it would have to be used by the media owner in whole or in part to finance other selling methods. It is just as much an element of cost as paper or circulation. Media owners would gladly save that 15% or a half or a third of it if they could.

The advertiser pays the agency commission only in the sense that the purchaser of anything pays the costs of making, selling and servicing it. That is the way of all commerce. But it is not the purchaser's money in any proprietary sense; it belongs to

the vendor, who pays those costs, and besides, the agency commission is not an added cost to any one if it saves other costs, or to the extent that it does so.

Do Agencies Fix Rate of Commission?

Haase contends (Page 3) that agencies and not media owners set the rate of agency commission, and that it has been fixed ever since 1918 at 15%, regardless of changes in the cost of doing business.

The first part of his contention is manifestly incorrect. To be sure, as the report says: "The owners of advertising mediums have been influenced and guided in their decision by agents." But that is far from fixing the price. As Haase's statement intimates, publishers make the decision.

Agencies have from time to time conferred with media owners about the amount of commission needed to cover expenses and a small profit, presenting figures of cost.

As to the latter part of the Haase contention, it is true that the agency commission has remained at 15% over a period of years, regardless of the cost of doing business, but that cost has been steadily upward, regardless of fluctuations in wage level, due to the expanding and increasing demands upon agencies for service. This is true also in a business depression, when agencies have to make one dollar of appropriation do the work of two. Any

temporary reduction in salaries paid to employees is more than offset by smaller appropriations and a keener effort to make them produce.

Do Agencies Earn a Commission from Media?

The Haase report seeks to discount agency service to media owners and hence its title to commissions allowed by them, specifically in respect to credit and the development of new advertisers.

In Regard to Credit Service -- It argues (Page 62) that agencies can not be held responsible for payment of bills incurred for an advertiser. The answer is: They ARE. They have to pay them, whether the advertiser reimburses or not. That is an universal custom of the trade. It is often also a contractual obligation. Agencies are not only liable; they are SOLELY liable, as has been evidenced by years of collection practice on the part of media owners.

The fact that over 60% of advertiser money is in the hands of the agency before it has to pay the media owner, as reported in the study, does not relieve the agency of liability to pay when the advertiser fails to do so. Credit losses are sometimes severe and are insured by some agencies at high expense. A recent official statement by media owners put them at millions of dollars.

The mere mechanics of collection from thousands of advertisers scattered all over the country and the work of watching and appraising their credit, would be a heavy burden on media owners, if the agency did not do that for them.

In Regard to Developing New Advertisers -- Haase deduces from Table VIII in the study that agencies do not originate as much new business as they should or as might be expected from a creative force subsidized by media owners to develop volume. (Pages 37 and 43)

The A.N.A. figures indicate that 91.3% of the reporting advertisers started to advertise on their own initiative and only 5.2% were induced to do so by advertising agencies. On the face of it, this does not look like a good creative record. But beneath the surface there are many currents of influence behind the advertiser's own "initiative," which go back to agency effort. Just as many consumers claim they are not influenced by advertising, and still use and wear, by preference, a great number of advertised products, so perhaps many advertisers, who themselves decide to advertise, may believe they do so solely on their own initiative.

Here is another factor to consider: In the present stage of advertising development prospective advertisers do not depend so much on soliciting effort as they did a few years ago. They are more effectively influenced to advertise by the successes they see all about them, largely produced by agency service. Agencies

are, in this indirect way, influential in creating new advertisers.

The problem today, as far as media owners are concerned, is to make advertising so widely resultful that it increasingly propagates itself. The agency's chief contribution to volume of advertising comes from its successful handling of accounts in hand, in making them grow as results justify that growth, and in finding new advertising opportunities for the client. That is a sound and meritorious growth, which is much more important in the development of new advertisers than any active soliciting effort.

According to Table IX, agency solicitation of large and established advertisers is on the increase and that is natural from a profit point of view. Agencies must live and they could not possibly live on new advertisers only. To the extent that such effort moves accounts into more effective hands, it is a net gain for the media owner.

Much new advertising has been created by agencies with and without the help of media salesmen, sometimes at high cost and with long sustained effort, as both agency and media records will testify. Perhaps more such effort should be made if it can be done without diverting from energies needed by existing clients.

Does Agency Recognition Protect Advertisers?

Haase rightly intimates that agency recognition does not of itself assure good service to advertisers. (Pages 17, 18, 19,

62 and 63) It is a safeguard, of course, in the case of some newspapers which adhere to the recognition list of the A.N.P.A. and in the case of a few outstanding periodicals which have done much to raise the standards of agency practice.

Agency "recognition" by media owners is intended merely to build up and make available to advertisers a selected group of agencies which meet the minimum requirements of media to practice advertising. Each advertiser must himself choose from among recognized agencies the one which seems best suited to his needs.

In its criticism of agency operation under the commission system, the Haase report fairly and squarely puts its finger on a weakness which should be overcome, and that is the inadequate control, by many media owners, of agency recognition. It is too loose and slipshod, especially in the newspaper and spot radio fields.

This is a great pity, since agency recognition by media owners is the only official test of professional merit in the agency business, and is capable of being made of great practical benefit to advertising and to advertisers. It should be put on an universal basis of recognized merit, as to character, experience, facilities and credit, and scrupulously adhered to by all media owners. Then it would be a real protection to the inexperienced advertiser, and prevent advertising graveyards for the media owner.

Is Agency Compensation Too Rigid?

In the last two paragraphs of its summary (Page 5), the Haase study points out how the agency business would thrive if and when the commission passed out -- and a more elastic method were employed. That's a friendly gesture, but it does not harmonize with the facts presented in Table XVI, showing that 14.7% of the reporting advertisers would not use agencies at all if commissions were abolished, and of those who would, three times as many would give the agency less compensation as would give it more -- and it might be added, the bargaining agency-client contract recommended in the study presupposes anything but liberal or non-technical treatment.

Haase complains that a fixed rate of commission, regardless of volume, yields the agency a supernormal profit on one account and a subnormal profit on another, so that the former really helps to finance service rendered the latter. This is quite true; and it would be true of any other workable method of compensation. It causes no hardship to advertisers; they all pay the same publication rate. But it is important to the development of advertising and hence to media owners, whose interests demand that all accounts, both large and small, have competent service.

This is a principle employed in their own business by advertisers themselves, who put into their price to regular customers the cost of soliciting prospects on whom they make a vain effort to sell, or sell at high cost a small bill of goods. They average

costs as well as profits over a wide range of trade.

On page 64 the study remarks that if a flexible arrangement for agency compensation could be made, "it would be possible for the advertiser to purchase the specific services necessary in his marketing program."

Such a selective use of agency services might prove unfortunate for both agency and advertiser and defeat the successful outcome of advertising which the agency commission is intended to secure.

The average advertiser would naturally endeavor to get along with a minimum of facilities, to save their cost to him, and thus deprive himself of forms of assistance the agency might deem vital to success.

From the agency's standpoint, such skimping of agency facilities would not only hamper effective service by it; it might also seriously impair the agency's financial ability to maintain such facilities at all. The 15% commission finances them and makes them available to all advertisers who need them, whether they are in a position to realize it or not.

Agency compensation is elastic in many particulars, but the backbone of it, the agency commission, cannot be elastic, for two major reasons. One concerns the media owner; the other, the agency. An elastic rate would destroy the media owner's set-up for developing his business, which he cannot afford to surrender. For agencies it would introduce a price competition and discount quality of service. In many cases they could not collect a

decent revenue for the service they render because that service is too intangible to establish a definite value. There would be no yardstick. Nobody knows how to measure creative service in terms of money nor how much credit to give any advertising effort. One cannot even protect advertising ideas from being stolen; their very authorship is hard to prove.

And who can determine how long an agency is entitled to benefit financially from a client's use of an advertising idea?

The principal product which advertising agencies have for sale is experience and ideas. Ideas are not created by the time-clock -- nor is their value measurable by it. No one can say how much time is spent in the generation of an idea. No one can say what it is worth. The same idea may be worth \$100,000 to one advertiser and only \$100 to another -- because the one is in position to use the idea in hundreds of media, and with millions of people -- whereas the other, because of the character of his business or financial limitations, may be confined in the use of the idea to a strictly local area. Perhaps after all, measuring the compensation for an idea or for services, by the extent to which the idea or those services are used -- is as logical and sound and equitable a method as any that could be devised. It is in keeping with the standard basis used in computing royalties and copyrights in all other fields of creative endeavor.

The agency's part in the work of advertising is the intangible part. And intangible services are universally the most difficult to protect.

This is perhaps especially true in the agency business, where competition is keen and sometimes destructive. The resulting demoralization would be equally detrimental to advertisers and media owners. They are equally interested in the reasonable profitability of agency operation, which alone will provide the necessary incentive for able men to engage in it.

If agency operation is to be attractive, either in financial return or in intellectual satisfaction, it is important that competition between agencies be kept out of the gutter of price chiseling and bickering, that the quality of service and not "price" determine which agency shall get the business and which shall retain it.

Under a fee system, advertising service would consist only of what the agency could get each individual client to pay for, and the client would utilize only such services as he himself determined he might need, and thus become the judge of how advertising should be conducted; though long ago he and the publisher both acknowledged, when they turned to the agency for service, that it is a field for specialists.

For the good of both publisher and advertiser, whose common interest the agency serves, it is vital that it conduct activities over and above the immediate needs of the individual advertiser, and for which many advertisers would not want to pay.

It is demonstrable that the advertising agency as an institution has made and does make valuable contributions to the study of markets and distribution methods. It calls attention to

product opportunities and product obsolescence, and helps create new products and improve old ones. It has aided scientific advertising coverage by its studies of circulation. Part of its business is to learn the use of new types of mediums as they come into being, and before they are generally used by the individual agency's advertisers. It makes contributions to publishing economies and technique, in studying mechanical needs and helping bring about improvement in plates, electrotypes, mats inks, publication sizes, etc.

Agencies are today digging constantly deeper into one of the most important of general activities, the scientific study of cause and effect in advertising copy.

All these activities and more are in the interest of making advertising pay the advertiser, yet often they are not a direct service to any individual advertiser, and certainly in the eyes of many would be regarded as unnecessary. But to advertising as a whole they are fundamentally valuable, and in the end make themselves felt in quality and economy of service to all clients.

Then there is another important though general service in which the agency system must be supported. The publisher is maintaining, in the form of the agency system, some hundreds of recognized service stations for some thousands of national advertisers.

It is sometimes to the best interests of the advertiser to shift his account from one agency to another. Any system would be faulty which did not give him free range in doing this because

even the best advertising agencies may at times slip in their service to accounts they once served well.

And if it is for the good of advertising that the advertiser have the facilities for change, it is also good for advertising that the agency be able to survive the loss, and preserve its organization for the service of other advertisers. To do this it must have income over and above what, in most cases, it could get from the advertiser in direct negotiations for specified work.

Not only can such services be most equitably paid for by a fixed percentage on the volume of advertising as a whole, but it is probable that in many cases this is the only way they would be adequately paid for.

The more carefully agency service is studied in all its parts and in all its equities, the sounder appears the view that it should be paid for by giving the agency a uniform percentage of the cost of the amount of advertising which the advertiser finds it profitable to use.

Looking at advertising as a whole, and at the agency system as a system, that is what happens now.

The commission method of agency compensation may bog down at times, in individual instances, and seem to do less than justice. But by and large it has succeeded. In the judgment of agencies, advertisers and media owners, or the great majority of them, it has made for better advertising, it has increased the effectiveness, and thereby has increased the use, of advertising. And it has done so with marked profit to those who have used it.

Media owners have likewise profited. They have built up through the years a creative force and harnessed it to the selling and service of their product -- space, time and circulation. They have done so with the agency commission which serves as a financial incentive to ever greater creative effort, directly for clients, indirectly for themselves.

Like the capitalistic system, it furnishes an incentive to creative effort which human nature needs, and like the capitalistic system, it also has its flaws. But far better the known weaknesses of the present system -- which after all does, by and large, work substantial justice -- than the unknown perils of untried panaceas.

* * * * *

SUMMARY

From the foregoing analysis, the following summary of conclusions seems amply justified:

1. The "general dissatisfaction" on the part of advertisers, claimed by the Haase report and assumed by the trustees who sponsored it, does not exist. On the contrary, while certain imperfections in the commission system are frankly recognized on all sides, that system seems to be definitely preferred to any other system that has as yet been put forward. According to Haase's own data, there is a large majority for that.

2. There is not, as claimed in the Haase report, any progressive trend towards advertisers' dispensing with the use of agencies, nor is there any breakdown of the present agency structure or method of compensation, deducible from the data presented by the Haase report.

3. The advertising agency is not, in any exclusive sense, as claimed by the Haase report, the agent of the advertiser. Neither is it exclusively the agent of the publisher. It is in many essentials an independent contractor, doing business on its own capital, and assuming the risk as to commitments made either for advertising space and radio time or for other expenditures.

4. Agencies have neither the moral nor the legal right to rebate commissions, in violation of the terms and conditions under which these are allowed.

The legal reasoning by which Haase attempts to justify rebating of commissions by agencies, on the ground that there can be no adverse interest between a principal and his agent and hence no transaction between them can be construed as rebating, is shown to be fictitious and inapplicable to that very transaction.

5. The publisher is deeply concerned with the continued health and vitality of the agency system, not because of what any one agency can do for him, but because a strong agency system, being indispensable to the effectiveness of advertising, is vital to him.

He is thoroughly justified, therefore, in seeing to it that agencies are properly financed and afforded an incentive to increase their creative effort for clients and hence for him. To that end he is thoroughly justified in allowing commissions to recognized agencies and in basing those commissions on reasonable agency costs, because if the existence of agencies is vital to him, their services are worth to him whatever it costs to keep those agencies operating effectively.

6. The publisher has the same right as any other manufacturer or merchandising concern, to determine the amount of commission that he shall allow on his product -- and whom he shall and whom he shall not allow a commission. And like any other manufacturer he has the right to refuse to assist in the tearing down of an organization, vital to him, by allowing that commission to any advertiser who buys of him "direct."

7. And as a corollary to the last statement the publisher has the right to prevent the doing by indirection and subterfuge of that which he can prohibit directly; in other words, he may insist that the agency to which he allows a commission may not use that commission in whole or in part, to reduce the price at which the advertiser buys his space.

8. The advertiser, under the present system, buys for his space dollar not only space in the publication but (if he chooses to avail himself of it without additional cost) the professional services of a "recognized" agency, of his own selection, to "service" that space.

9. If he wishes to pay compensation to his agency in addition to the compensation that the agency receives from the publisher

as a commission, he is of course at liberty to do so. The publisher neither has nor claims the right to prevent such additional compensation. In fact, as is shown by the Haase report and as is universally known, most agencies do receive some compensation directly from their clients for service which the advertiser and agency do not believe is adequately paid for in commissions alone.

10. No agency can afford to favor commissionable billing TO THE DETRIMENT OF A CLIENT. The client's interests come first; in no other way can an agency serve its own true interest; it can not afford to jeopardize success for any immediate or temporary gain. It would be a fool to do so.

In isolated cases where such a short-sighted policy might exist, it would also exist with a fee system or any other method of compensation, since there would always be some forms of advertising service which secure for the agency more employment or a more profitable use of its facilities, than do others. The temptation would still be there.

Any temptation to favor commissionable expenditures as against non-commissionable, can easily be removed by the advertiser's putting non-commissionable expenditures on an equal or proportionate basis of pay, as is now generally done for mechanical and art work.

11. The principal product which advertising agencies have for sale is ideas. Ideas are not created by the time-clock -- nor is their value measurable by the time-clock. No one can say how much time is spent in the generation of an idea. No one can say what it is worth. The same idea may be worth \$100,000 to one advertiser and only \$100 to another -- because the one is in position to use the idea in hundreds of media, and with millions of people -- whereas the other, because of the character of his business or financial limitations, may be confined in the use of the idea to a strictly local area. Perhaps after all,

with all its illogicalities and imperfections, the commission system -- which measures the compensation for an idea or for services, by the extent to which the idea or those services are used -- is as logical and sound and equitable as any that could be devised.

* * * * *

COLUMBIA
UNIVERSITY
LIBRARY

Date Due

COLUMBIA UNIVERSITY LIBRARIES
0044260490

MSH 01671.

NEH

MAY 04 1994

FEB 4 1936

MAY 14 1936

**END OF
TITLE**